

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

JOHN PARASCHOS, et al.,	:	CIVIL ACTION
Plaintiffs	:	
	:	
v.	:	
	:	
YBM MAGNEX INTERNATIONAL, INC.,	:	
et al.,	:	
Defendants	:	NO. 98-6444

Newcomer, S.J.

March , 2000

**M E M O R A N D U M**

Presently before this Court are the following slew of motions filed by ten of the eleven defendants<sup>1</sup> in this action:

(1) Defendant Parente, Randolph, Orlando, Carey & Associates' Motion to Dismiss Claims of Canadian Plaintiffs on the Grounds of Comity;

(2) Defendant Parente, Randolph, Orlando, Carey & Associates' Motion to Dismiss pursuant to the Private Securities Litigation Reform Act of 1995 ("Reform Act") and Federal Rules of Civil Procedure 9(b) and 12(b)(6);

(3) Defendant R. Owen Mitchell's Motion to Dismiss Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 12(b)(6) and 12(b)(1);

(4) Defendant Deloitte & Touche LLP's Motion to Dismiss Plaintiff's Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 12(b)(6) and the Reform Act;

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<sup>1</sup>All actions, including the instant proceedings, against YBM have been stayed and enjoined due to bankruptcy proceedings in the Bankruptcy Court. YBM, therefore, has not filed a motion to dismiss here.

(5) Defendant David R. Peterson's Motion to Dismiss Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 12(b)(6);

(6) Defendants James J. Held's and Guy R. Scala's Motion to Dismiss Plaintiff's Consolidated Amended Complaint pursuant to Rule 12(b)(6);

(7) Defendants Harry Antes' and Frank Greenwald's Motion to Dismiss pursuant to Fed.R.Civ.P. 12(b)(1) and 12(b)(6)<sup>2</sup>;

(8) Defendant Jacob Bogatin's Motion to Dismiss Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 9(b) and 12(b)(6)<sup>3</sup>; and

(9) Defendant Daniel E. Gatti's Motion to Dismiss pursuant to Fed.R.Civ.P. 12(b)(6) and 12(b)(1).

For the reasons discussed below, the motions to dismiss are DENIED and the case shall go forth so that the parties may begin discovery.

#### **I. BACKGROUND**

Plaintiffs bring this consolidated class action on behalf of persons who purchased the common stock of defendant YBM Magnex International Inc. ("YBM") between January 19, 1996 and

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<sup>2</sup>Defendants Harry Antes and Frank Greenwald have also filed a Motion Joining in Defendant Parente, Randolph, Orlando, Carey & Associates' Motion to Dismiss Claims of Canadian Plaintiffs on the Grounds of Comity.

<sup>3</sup>Defendant Bogatin moves, in the alternative, to dismiss strike portions of the consolidated Amended Complaint pursuant to Fed.R.Civ.P. 12(f).

May 14, 1998<sup>4</sup> alleging: (1) violations of section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5; (2) violations of section 20(a) of the Exchange Act; and (3) state law claims of negligent misrepresentation. Plaintiffs have named as defendants: (1) YBM; (2) Parente, Randolph, Orlando, Carey & Associates ("Parente"), a firm of certified public accountants; (3) Deloitte & Touche, LLP ("Deloitte"); (4) Jacob G. Bogatin, former President, Chief Executive Officer, and member of the Board of Directors of YBM; (5) Harry W. Antes, former Chairman of the Board of YBM; (6) R. Owen Mitchell, former member of the Board of YBM and Chairman of several Special Committees of the Board; (7) Frank Greenwald, former member of the Board of YBM; (8) David R. Peterson, former member of the Board of YBM and former Premier of the Province of Ontario; (9) Daniel E. Gatti, former Vice President of Finance and Chief Financial Officer of YBM; (10) James J. Held, former Vice President of Business Development and Investor Relations of YBM; and (11) Guy R. Scala, former Vice President of Sales and Marketing of YBM.

In sum, plaintiffs allege that defendants engaged in an elaborate fraud over the course of several years, during which time YBM allegedly held itself out as a manufacturer of magnets and a participant in several other businesses, when in fact YBM was a front for the laundering of money obtained by Russian organized crime. Plaintiffs aver that their claims arise from a

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<sup>4</sup>Any persons who may qualify as members of the class shall hereinafter be referred to collectively as "the Class".

scheme to launder the proceeds of organized crime activities in Eastern Europe, to convert the criminal revenue to clean money through lawful sales of the common stock of YBM, and to defraud purchasers of YBM's common stock.

With regard to the § 10(b) and Rule 10b-5 claims, plaintiffs contend that defendants carried out a course of conduct which was intended to and did deceive the investing public, artificially inflate and maintain the market price of YBM common stock, and cause plaintiffs and other members of the Class to purchase YBM common stock at artificially inflated prices. The plaintiffs allege that the defendants who were insiders of YBM ("Insider defendants") are liable because each was a high-level executive and/or director of YBM during the Class period and/or was a member of the company's senior management; each was privy to and participated in the preparation of YBM's financial statements and reporting of the company's financial condition, operations, and performance; each enjoyed significant personal contact and familiarity with other Insider defendants and was advised of and had access to other members of YBM's management team, internal reports, and other data and information about the company's resources at all relevant times; and each was aware of YBM's dissemination of information to the investing public which each knew or recklessly disregarded as materially false and misleading.

Plaintiffs contend that the auditors violated § 10(b) of the Exchange Act and Rule 10b-5 because they rendered

unqualified opinions on the company's financial statements despite knowing or recklessly disregarding that YBM's financial statements contained materially false representations, including representations of revenue, earnings, and business operations. Plaintiffs assert that these actions were an extreme departure from a standard of ordinary care.

The second claim for violation of § 20 of the Exchange Act applies only to the Insider defendants, who allegedly acted as controlling persons of YBM, and had the power to, and did, influence and control the decision-making of the company. Plaintiffs assert that the Insider defendants' decisions included the content and dissemination of various public statements that plaintiffs contend are false and misleading. Plaintiffs claim that pursuant to § 20(a), the Insider defendants are liable jointly and severally with and to the same extent as the company for its violations of § 10(b) and Rule 10b-5.

The third claim for negligent misrepresentation is brought against all defendants for their alleged failures to state material facts necessary: (1) in order to make the statements, in light of the circumstances under which they were made, not misleading, and (2) in order that prospective investors in YBM common stock would have all the material facts necessary for an informed decision.

Defendants' instant motions to dismiss, filed in response to plaintiffs' consolidated Amended Complaint ("Complaint"), fall into 3 general categories: (1) dismissal

based on a lack of subject matter pursuant to 12(b)(1), or alternatively, dismissal based on concerns of international comity; (2) dismissal based on plaintiffs' failure to plead fraud with particularity pursuant to Rule 9(b) and the Reform Act; and (3) dismissal based on the failure to state a claim pursuant to Rule 12(b)(6). The Court will now discuss these issues in turn.

## II. DISCUSSION

### A. DISMISSAL: SUBJECT MATTER JURISDICTION AND COMITY

Defendant Parente, Randolph, Orlando, Carey & Associates ("Parente") filed a Motion to Dismiss Claims of Canadian Plaintiffs on the Grounds of Comity ("Comity Motion"), which was joined by defendants Harry W. Antes and Frank Greenwald through their Motion to Join in Motion to Dismiss Claims of Canadian plaintiffs. Defendants Mitchell, Held, Scala, Bogatin, and Gatti also joined in Parente's Comity Motion through their respective motions to dismiss.<sup>5</sup>

Defendants contend that YBM was a Canadian corporation, was offered by Canadian underwriters, was traded solely on Canadian stock exchanges and never on any U.S. exchanges, and was

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<sup>5</sup>This Court notes that these 5 defendants join in Parente's Comity Motion, but mislabel said Comity Motion as a motion to dismiss based on lack of subject matter jurisdiction pursuant to Rule 12(b)(1). As pointed out in both Parente's Comity Motion (note 12, page 13) and Parente's Reply Brief (page 1), Parente's argument is not that this Court lacks subject matter jurisdiction under the federal securities laws, but rather that this Court should exercise its discretion and dismiss the claims of the Canadian plaintiffs as a matter of comity. As a preliminary matter, this Court will address its subject matter jurisdiction over this matter under the federal securities laws.

a "reporting issuer" with the Canadian provincial securities commissions in Ontario, Alberta, Quebec and British Columbia. In essence, defendants argue that as a matter of comity this Court should exercise its discretion and dismiss the claims of the Canadian plaintiffs in order that they may be adjudicated under Canadian law in a Canadian court because of the underlying Canadian nature of this action and the circumstances that give rise to it.

Defendants argue that the Canadian plaintiffs are taking advantage of a U.S. forum to apply the U.S. securities laws to determine their rights and remedies with respect to a foreign corporation: (1) whose securities the plaintiffs purchased in their own country; (2) which was incorporated in plaintiffs' own country; (3) whose shares traded solely on a stock exchange in plaintiffs' own country; (4) whose financial statements were prepared in accordance with the GAAP of the plaintiffs' own country; and (5) whose securities were regulated by the securities authorities of the plaintiffs' own country. Moreover, defendants posit that Canada has a judicial forum and a fully articulated body of law available to the plaintiff. Defendants point to two separate shareholder class actions that were filed in Canada: one class covering plaintiffs who made open market purchases, and of which the Canadian plaintiffs here would be members; and another class covering a proposed class of Canadian investors who bought in YBM's November 17, 1997 public offering.

Plaintiffs respond to defendants' arguments by arguing that this Court does in fact have jurisdiction over this action, and that relevant policy considerations and caselaw provide reasons for this Court not to dismiss the Canadian plaintiffs on grounds of comity.

**1. EXTRATERRITORIAL SUBJECT MATTER JURISDICTION OF THE EXCHANGE ACT**

As a preliminary matter, and to address any arguments that this Court may not have subject matter jurisdiction over this action, the Court will begin by discussing its extraterritorial subject matter jurisdiction under the federal securities laws.

Section 27 of the Exchange Act vests federal courts with exclusive jurisdiction over actions involving violations of the Exchange Act, as well as rules and regulations adopted thereunder. However, neither the Exchange Act nor the Rules promulgated thereunder provide specific guidance as to the extraterritorial application of the Act. "Although the preamble to the [Exchange] Act expressly contemplates its application to transactions in 'interstate and foreign commerce,' . . . thereby suggesting Congress intended a broad jurisdictional scope, . . . the specific provisions of the statute itself are silent with respect to its extraterritorial reach. Starlight Int'l, Inc. v. Herlihy, 13 F.Supp.2d 1178, 1182 (D. Kan. 1998) (citations omitted).

In the absence of clear statutory guidance, the Second Circuit has extensively considered the application and extraterritorial jurisdiction of the federal securities laws to transnational transactions and fraud. The Second Circuit has developed two alternative tests for determining when federal securities laws apply extraterritorially: the "conduct test," which in essence asks whether the fraudulent conduct that forms the alleged violation occurred in this country; and the "effects test," which asks whether conduct outside the United States resulted in substantial adverse effects on American investors or securities markets. See Robinson v. TCI/US West Communications, 117 F.3d 900, 905 (5th Cir. 1997). It has been held that satisfaction of either test is enough to confer subject matter jurisdiction on the court. See Id.

In the instant case, plaintiffs' briefs appear to rely on the "conduct test" to satisfy jurisdictional requirements. They argue that defendants' fraudulent conduct and misrepresentations took place in the United States, and therefore defendants should be held liable under U.S. securities law. The courts of appeals however, have not agreed on the type of activities required to satisfy the conduct test, although all agree that essentially, the test is based "on the idea that Congress did not want the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners." Id. (citations omitted). The Second, Fifth, and District of Columbia Circuits have held

that the domestic conduct be "of material importance" to, or "have directly caused" the alleged fraud. Id. at 905-06. The Third Circuit, however, along with the Eighth and Ninth Circuits, requires only that the domestic conduct be significant to the fraud rather than a direct cause of it. Id. at 906 (citing SEC v. Kasser, 548 F.2d 109, 114 (3d Cir. 1977)).

The facts of the instant action meet the criteria of the conduct test, and the defendants' conduct in the United States was of such significance that subjecting them to the jurisdiction of this Court is proper. Most, if not all, of defendants' conduct allegedly took place in the United States. The misrepresentations concerning YBM, as well as the audits of the company, which plaintiffs contend constitute the fraud, occurred domestically. Furthermore, if plaintiffs' allegations are proven, defendants' conduct would easily be found to have been significant to the alleged fraud and plaintiffs' subsequent reliance on said fraud.

Even under the stricter reading of the conduct test, plaintiffs have sufficiently pleaded that defendants' alleged domestic conduct: (1) was more than "merely preparatory," and (2) directly caused their injury and losses. See Bersche v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975), cert. denied, 423 U.S. 1018 (1975). Plaintiffs claim that the misrepresentations and fraud that occurred in the U.S. were part of an elaborate scheme, which indicates that defendants' conduct was more than mere preparation. Furthermore, there is little

doubt that if plaintiffs allegations are proven, the misrepresentations and fraud, upon which plaintiffs allegedly relied, directly led to and caused plaintiffs' injuries. Therefore, this Court finds that it has proper extraterritorial subject matter jurisdiction over this matter under U.S. securities laws; and plaintiffs can properly bring this action under the Exchange Act.

## 2. INTERNATIONAL COMITY

This Court now turns to the brunt of defendants' motions to dismiss based on comity. The principle of international comity, also known as the "comity of nations doctrine," permits the "recognition of foreign proceedings to the extent that such proceedings are determined to be orderly, fair and not detrimental to the nation's interests." Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, 165 B.R. 379, 384 (S.D. N.Y. 1994). The Supreme Court in Hilton v. Guyot, 159 U.S. 113, 164 (1895) defined international comity as:

"the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws."

When the extraterritorial enforcement of United States law creates an actual or potential conflict with the laws or policies of the nations, it is appropriate for the enforcing court to consider whether, in light of considerations of comity, it should decline to exercise jurisdiction and to enforce the United States

law. See Westel de Venezuela v. American Telephone and Telegraph Co., CIV.A. No. 6665, 1992 WL 209641, at \*19 (S.D. N.Y. Aug. 17, 1992) (citing Timberlane Lumber Co. v. Bank of America National Trust & Savings Association, 749 F.2d 1378, 1384 (9th Cir. 1984), cert. denied, 472 U.S. 1032 (1985)).

Under the principle of comity between sovereign nations, a district court should decline to exercise jurisdiction under certain circumstances in deference to the laws and interests of another foreign country. Basic v. Fitzroy Engineering, Ltd., 1997 WL 753336, at \*8 (7th Cir. 1997) (citing Societe Nationale Industrielle Aerospatiale v. United States District Court for the Southern District of Iowa, 482 U.S. 522, 543 n.27 (1987). "United States courts ordinarily . . . defer to proceedings taking place in foreign countries, allowing those . . . proceedings to have extraterritorial effect in the United States." Pravin Bank Assocs., 109 F.3d at 854 (citations omitted).

Many federal courts have dismissed cases solely on the basis of comity. See Fleeger v. Clarkson Co. Limited, 86 F.R.D. 388, 392 (N.D. Tex. 1980) (citing Cornfeld v. Investors Overseas Services, Ltd., 471 F.Supp. 1255 (E.D. N.Y. 1979), and pointing to cases cited therein at 1262). The rationale for dismissals based on comity is not based simply on a lack of familiarity with the particular foreign law, but rather is in deference to the foreign country's legal, judicial, legislative, and administrative system of handling disputes over which it has

jurisdiction, in a spirit of international cooperation. Id. (citing Cornfeld, 471 F.Supp. at 1262). However, comity is not extended to foreign proceedings when doing so would be contrary to the public policy of the U.S. Pravin, 109 F.3d at 854.

In a situation such as the instant one, a district court is also empowered, in the interests of international comity, to dismiss a federal suit whenever it is duplicative of a parallel action pending in courts in a foreign country. Ingersoll Mill. Mach. Co. v. Granger, 833 F.2d 680, 685 (7th Cir. 1987). An action is parallel to another action when "substantially the same parties are contemporaneously litigating substantially the same issues in another forum." Caminiti & Iaarola, Ltd. v. Behnke Warehousing, Inc., 962 F.2d 698, 700 (7th Cir. 1992). The two actions may be parallel when the parties share some legal identity of interest such that they are "substantially the same." Id. at 700-01. Though the actions do not have to be identical, the issues must be sufficiently similar, in that there must be a "substantial likelihood that the [foreign] litigation will dispose of all claims presented in the federal case." Lumen Constr., Inc. v. Brant Constr. Co., 780 F.2d 691, 695 (7th Cir. 1985).

Even when two suits are parallel, however, a district court should exercise jurisdiction over an action even where identical subject matter is concurrently before a foreign court. See Ingersoll, 833 F.2d at 684. The court should look to extraordinary circumstances that necessitate dismissal, including

the desirability of avoiding duplicative litigation, the inconvenience of the domestic forum, the governing law, the order in which jurisdiction was obtained in each forum, the relative progress of each proceeding, and the contrived nature of the domestic claim. See Balcom v. Rosenthal & Co., CIV.A. No. 96-6310, 1998 WL 2835 (N.D. Ill. Jan. 2, 1998) (citing Ludgate Ins. Co. v. Becker, 906 F.Supp. 1233, 1242 (N.D. Ill. 1995)).

Defendants have pointed to extensive policy reasons supporting dismissal of the present claims of the Canadian plaintiffs; and in general, this Court agrees with many of them. Defendants' arguments are very persuasive. It is true that the Canadian courts serve as a reliable alternative to this Court and can be trusted to be orderly, fair, and not detrimental to this country's interests. Defendants have also successfully shown that many of the legal issues in this case arise from circumstances that are transnational (Canadian) in nature. In addition, the interests of international duty as well as judicial economy and convenience are very legitimate issues in this case.

However, the reasons for maintaining jurisdiction of this case are more compelling. To the extent that subject matter jurisdiction over this case is proper, plaintiffs, even foreign plaintiffs, should be permitted to bring their claims in the forum of their choice. More importantly, the deciding factor for this Court is plaintiffs' clear choice of law. The Canadian plaintiffs bring their claims under U.S. securities law, not Canadian law. Plaintiffs have specifically chosen to utilize the

jurisdiction afforded to them to have their claims brought under the Exchange Act and have them adjudicated in a United States district court.

That being the case, this Court acknowledges the absence from this case some of the more important factors of comity dismissal. First, the pending cases in the Canadian courts involve different legal issues. As defendants point out, the Canadian courts will not be applying U.S. securities law. Therefore, while defendants claim that there are conflict of law issues, there appear to be no actual or potential conflicts of law. The claims under the Exchange Act, as well as the state law claims for negligent misrepresentation, are not in conflict with Canadian law or the cases presently pending in the Canadian courts. Consequently, those issues being tried in Canada do not preclude the instant action; and conversely, the issues in this case should not estop any of the issues being tried in the Canadian proceedings. The claims brought here are distinct from those other claims in the foreign court, and this Court chooses to allow plaintiffs to bring their claims here.

Second, this Court feels that dismissal of this action would not be out of a spirit of international cooperation in deference to Canada's legal, judicial, legislative, and administrative system of handling disputes. Rather, dismissal of plaintiffs' claims would turn out to be an outright dismissal of plaintiffs' legitimate U.S. securities law claims. Plaintiffs would lose out on the protections of U.S. law that are available

to them under the extraterritorial applications of the Exchange Act. If this action were brought under Canadian law, or if this Court was being asked to apply Canadian law, it would be an entirely different matter and a different holding may very well result. However, since this Courts is the only forum in which the Canadian plaintiffs have brought their legitimate U.S. securities law claims, they will not be prevented from doing so.

**B. DISMISSAL: FAILURE TO STATE A CLAIM AND FAILURE TO PLEAD WITH PARTICULARITY**

Each of the defendants has also moved this Court to dismiss for plaintiffs' failure to state a cause of action pursuant to Rule 12(b)(6). In conjunction with their motions defendants argue that plaintiffs have failed to satisfy heightened pleading requirements that apply to their § 10(b) and Rule 10b-5 claims.

**1. LEGAL STANDARD: MOTION TO DISMISS**

Under Rule 12(b)(6), a court should dismiss a claim for failure to state a cause of action only if it appears to a certainty that no relief could be granted under any set of facts which could be proved. Hishon v. King & Spalding, 467 U.S. 69, 73 (1984). Because granting such a motion results in a determination on the merits at such an early stage of a plaintiffs' case, the district court "must take all the well pleaded allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the pleadings, the plaintiff may be

entitled to relief." Colburn v. Upper Darby Township, 838 F.2d 663, 664-65 (3d Cir. 1988), cert. denied, 489 U.S. 1065 (1989) (quoting Estate of Bailey by Oare v. County of York, 768 F.2d 503, 506 (3d Cir. 1985)). "To withstand the motion, 'it is not necessary to plead facts upon which the claim is based.'" In re Meridian Sec. Litig., 772 F.Supp. 223, 226 (E.D. Pa. 1991) (quoting In re Midlantic Corp. Shareholder Litig., 758 F.Supp. 226, 230 (D. N.J. 1990) in the context of assessing Rule 12(b)(6) motions to dismiss § 10(b) claims).

**2. LEGAL STANDARD: PLEADING REQUIREMENT UNDER  
FED.R.CIV.P. 9(b) AND THE REFORM ACT**

Federal Rule of Civil Procedure 9(b) and the Reform Act require that a securities fraud claim be subject to heightened pleading requirements. Because § 10(b) and Rule 10b-5 are anti-fraud provisions, plaintiffs must plead them with the particularity required by Rule 9(b) and the Reform Act.<sup>6</sup> See In re Burlington Coat Factory, Sec. Litig., 114 F.3d 1410, 1417 (3d Cir. 1997).

Rule 9(b) provides that "[i]n all averments of fraud or mistake, the circumstances constituted fraud or mistake shall be stated with particularity." The purposes of Rule 9(b) are to provide notice of the precise misconduct with which defendants

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<sup>6</sup>However, Rule 9(b) and the Reform Act do not apply to claims grounded in negligence, so plaintiffs are not required to satisfy the heightened pleading requirements for their negligence misrepresentation claims against defendants. See Shapiro v. UJB Fin. Corp., 964 F.2d 272, 288 (3d Cir.), cert denied, 113 S.Ct. 365 (1992).

are charged and to "safeguard defendants against spurious charges of immoral and fraudulent behavior." Seville Indus. Mach. v. Southmost Mach., 742 F.2d 786, 791 (3d Cir.1984); See Rolo v. City Investing Co., 155 F.3d 644, 658 (3d Cir.1998) (citations omitted).

"As long as the allegations of fraud reflect precision and some measure of substantiation, the complaint is adequate." Meridian, 772 F.Supp. at 229 (citing Seville, 742 F.2d at 791). While allegations of time, place, and date certainly meet this requirement, see Rolo, 155 F.3d at 658, allegations that set forth the details of the alleged fraud may also meet these requirements, and plaintiffs "are free to use alternative means of injecting precision and some measure of substantiation into their allegations of fraud." Seville, 742 F.2d 791 (finding that plaintiff had met burden when it incorporated into the complaint a list of the pieces of machinery allegedly subject to fraud and otherwise described the "nature and subject" of the supposed misrepresentations); Saporito v. Combustion Eng'g, Inc., 843 F.2d 666, 675 (3d Cir.1988), judgment vac'd on other grounds, 489 U.S. 1049, 109 (1989) (stating that plaintiff did not meet burden when it pled in very general terms, and did not allege who made or received fraudulent statements). As to scienter, plaintiffs must allege specific facts that give rise to a 'strong inference' that defendants possessed the requisite intent. Burlington Coat Factory, 114 F.3d at 1418.

The Third Circuit has repeatedly cautioned that courts should apply this rule flexibly, particularly when the information at issue may be in the defendants' control. See Seville, 742 F.2d at 791. In fact, the Third Circuit has held that:

[c]ourts must be sensitive to the fact that application of Rule 9(b) prior to discovery 'may permit sophisticated defrauders to successfully conceal the details of their fraud.' Particularly in cases of corporate fraud, plaintiffs cannot be expected to have personal knowledge of the details of corporate internal affairs . . . . Thus, courts have relaxed the rule when factual information is peculiarly within the defendant's knowledge or control.

In re Craftmatic Sec. Litig., 890 F.2d 628, 645 (3d Cir. 1989) (citations omitted). In addition, the Craftmatic Court "expressly declined to adhere to the rigid enforcement of Rule 9(b) in securities fraud cases." In re Midlantic Corp. Shareholder Litig., 758 F.Supp. 226, 232 (D. N.J. 1990) (citing Craftmatic, 890 F.2d at 645-46).

The Reform Act requires that a plaintiff alleging that a defendant has made misleading statements must:

specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

15 U.S.C. § 78u-4(b)(1).

To establish scienter under the Reform Act, plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of

mind." 15 U.S.C. S 78u-4(b)(2). The Third Circuit has held that under the requirement, plaintiffs must "allege specific facts that give rise to a 'strong inference' that defendants possessed the requisite intent." Marra v. Tel-Save Holdings, Inc., CIV.A. No. 98-3145, 1999 WL 317103, at \*11 (May 18, 1999) (quoting Burlington Coat Factory, 114 F.3d 1418). This standard can be satisfied either "(a) by alleging facts to show that defendants had both motive and opportunity to commit fraud; or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." Marra, 1999 WL 317103, at \*11 (quoting Burlington Coat Factory, 114 F.3d 1418). Therefore, allegations that defendants had both motive and opportunity to commit fraud are sufficient to plead scienter under § 10(b). Marra, 1999 WL 317103, at \*11 (citing In re Home Health Corp. of Am., Inc., CIV.A. No. 98-834, 1999 WL 79057, at \*14 (E.D. Pa. Jan. 29, 1999)). While the Reform Act clearly requires some precision in alleging facts, it does not require pleading all of the evidence and proof thereunder supporting a plaintiff's claim. In re Cephalon Sec. Litig., CIV.A. No. 96-0633, 1997 WL 570918 (E.D. Pa. Aug. 29, 1997).

### **3. LEGAL STANDARDS AND ELEMENTS OF PLAINTIFFS' CLAIMS**

#### **a. SECTION 10(b) AND RULE 10b-5**

To state a claim under § 10(b) and Rule 10b-5, a plaintiff must plead the following elements: (1) that a defendant made misstatements or omissions of material fact; (2) with

scienter; (3) in connection with a purchase or sale of securities; (4) upon which the plaintiff relied; and (5) plaintiff's reliance was the proximate cause of plaintiff's injury. See Kline v. First W. Gov't Sec., Inc., 24 F.3d 480, 487 (3d Cir. 1994).

**b. CONTROL PERSON LIABILITY UNDER § 20(a)**

Section 20(a) of the Exchange Act states in relevant part:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the acts constituting the violation or cause of action.

15 U.S.C. § 78t(a). To establish liability under § 20(a), a plaintiff must prove: (1) a primary violation occurred; (2) the defendant had control over the person responsible for the violation; and (3) the defendants acted culpably. See In re Cephalon Sec. Litig., CIV.A. No. 96-0633, 1997 WL 570918, at \*14 (E.D. Pa. Aug. 29, 1997).

In assessing a plaintiff's pleadings for § 20(a), Third Circuit precedent requires the court to give consideration to the powers inherent in the defendants' positions:

Substantial weight must be given to the authority, or rather the potential authority, inherent in such corporate positions, considered separately or in concert. Furthermore, prior to discovery, plaintiff can hardly be able to plead the precise culpable conduct of each individual defendant.

Midlantic, 758 F.Supp. at 236.

**c. NEGLIGENT MISREPRESENTATION**

Under Pennsylvania law, liability for negligent misrepresentation will arise if: (1) the misrepresentation is of a material fact; (2) the representor knew of the

misrepresentation, but (3) made the misrepresentation without knowledge of its truth or falsity or made it under such circumstances in which he ought to have known of its falsity; (4) the representor intended the representation to induce another to act on it; (5) the other person justifiably relied upon the misrepresentation; and (6) if in so relying, suffered damages or injury. City of Rome v. Glanton, 958 F.Supp. 1026, 1039 (E.D. Pa.1997); Amoco Oil Co. v. McMahon, 1997 WL 50448 (E.D. Pa. 1997).

#### **4. ANALYSIS OF DEFENDANTS' MOTIONS TO DISMISS**

In their extremely lengthy Complaint, plaintiffs set forth a detailed list of allegations, depicting a complex scheme of fraud and money laundering. Within this portrait of deception and misrepresentation, plaintiffs weave facts that each of the defendants were in a position to know of the scheme, and ultimately, through intentional and/or negligent actions, became liable because of their involvement.

**a. SECTION 10(b) AND RULE 10b-5**

With regards to the § 10(b) and Rule 10(b)-5 claims, plaintiffs allege a myriad of misstatements and omissions of material fact. The misstatements and omissions include those stemming from YBM's Prospectuses, press releases, and annual reports concerning various representations of the company's business, income, and growth, as well as omissions concerning certain criminal connections and investigations made by the U.S. law enforcement authorities. Plaintiffs also allege that misstatements and omissions were made by the auditors in the form of unqualified, clean audit reports of YBM's finances, when in fact much of the company's financial information was false or nonexisting. Furthermore, despite defendants' arguments to the contrary, plaintiffs sufficiently plead scienter through strong inferences that may be drawn from the factual allegations laid out in the Complaint. Plaintiffs' Complaint alleges facts that show inferences that defendants had both motive and opportunity to commit fraud as well as facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. When read in the light most favorable to them, plaintiffs' collective allegations strongly infer that each of the defendants was in a position to know of the company's true financial status, knowingly signed off on, or assented to many of the company's misrepresentations or omissions.

For instance, plaintiffs allege, inter alia: (1) defendant Bogatin finalized and signed YBM's 1995 Annual Report,

which allegedly contained false information; (2) defendant Mitchell allegedly minimized "inconsistencies" in shareholder records and testimony, and misreported results of an investigation of the Special Committee; (3) defendant Antes joined Bogatin in finalizing and signing YBM's 1996 Annual Report which allegedly contained false information; (4) defendant Greenwald was allegedly involved in, and subsequently silent about, an Audit Committee meeting where Deloitte expressed concerns about first quarter 1998 earnings that might have been impacted by certain transactions questioned by Deloitte; (5) defendant Gatti, with others, provided numerous YBM documents and other information to Deloitte in 1997 while informing Deloitte that YBM's oil sales were flagged for particular attention by the Ontario Securities Commission, inferring that Gatti as a vice president knew of YBM's misrepresentations and assented to them; and (6) defendants Held, Scala, and Peterson allegedly made comments in various articles regarding YBM's financial status, when they were in positions to know that their statements were false and misrepresentative. The Court also finds that the aggregate of allegations against the outside auditors, Parente and Deloitte, raises strong inferences of their scienter. They were in positions to know YBM's true financial situation; and yet proceeded to make misrepresentations or omissions of material facts concerning those finances. With the aforementioned determinations, this Court feels that discovery is necessary to

unearth the evidence, if any, to support plaintiffs' allegations of § 10(b) and Rule 10b-5 violations.

**b. SECTION 20(a)**

Despite some of the Insider defendants' contentions that plaintiffs have failed to show they were in fact insiders, the Court finds that plaintiffs' allegations, if proven, are sufficient to show that the Insider defendants were in positions with authority and inherent powers to control YBM. Therefore, in conjunction with the determination that a primary violation of § 10(b) and Rule 10b-5 have been sufficiently alleged against YBM, this Court finds that § 20(a) has also been adequately pleaded against the Insider defendants.

**c. NEGLIGENT MISREPRESENTATION**

Because plaintiffs' Exchange Act claims will not be dismissed, this Court will exercise supplemental jurisdiction over plaintiffs' state law claim for negligent misrepresentation. As was the case for their other claims noted above, plaintiffs have adequately pleaded their causes of action for negligent misrepresentation against the individual Insider defendants as well as the outside auditors to withstand the instant motions to dismiss. The Court determines that plaintiffs' well-pleaded allegations warrant that this case move forward into discovery, after which time the parties may wish to file appropriate dispositive motions.

**d. CONCLUSION**

Upon consideration of the Complaint, and when plaintiffs' allegations are read in the light most favorable to them, it does not appear to a certainty that no relief could be granted under any set of facts which could be proved.

Although these allegations in the Complaint lack absolute factual specificity, the Court is satisfied that at this early stage of the action plaintiffs' pleadings are sufficient to withstand the instant motions to dismiss. The Court finds the Complaint is adequate and sufficient to satisfy the purposes of heightened pleading requirements.<sup>7</sup> In particular, plaintiffs have adequately pleaded with enough particularity regarding the numerous elements of their claims to provide sufficient notice of the precise misconduct with which defendants are charged. The Court is also convinced by the pleadings that the instant allegations are not simply spurious charges of immoral and fraudulent behavior.

Moreover, many of the allegations pertaining to fraudulent conduct by the individual defendants refer to information that is largely within the defendants' control, and it would be inappropriate to penalize the plaintiffs at this stage for their lack of specific information, given the general flexibility with which the Third Circuit instructs courts to

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<sup>7</sup>The Court notes that plaintiffs would have been granted leave to amend their Complaint further upon a dismissal at this early stage. Therefore, rather than have plaintiffs refile another amended complaint simply to satisfy stringent pleading requirements, the Court chooses to move this case forward into the discovery phase.

apply Rule 9(b). Consequently, any dispositive issues should be kept until the summary judgment stage after substantial discovery has been completed.

**C. DEFENDANT BOGATIN'S MOTION TO STRIKE PARAGRAPHS FROM THE COMPLAINT**

Defendant Bogatin seeks pursuant to Rule 12(f) to have this Court strike paragraphs 35, 151, 152, and 153 of the Complaint. A motion to strike under Rule 12(f) of the Federal Rules of Civil Procedure is the proper method to eliminate matters which are found to be redundant, immaterial, impertinent or scandalous. Fed.R.Civ.P. 12(f). Motions to strike under 12(f) are viewed with disfavor. Great West Life Assur. Co. v. Levithan, 834 F.Supp. 858, 864 (E.D. Pa. 1993). Even "[a]llegations in a complaint which supply background or historical material or which are of an evidentiary quality will not be stricken unless unduly prejudicial to defendant." South Side Drive-In Co. v. Warner Bros. Pictures Distrib. Corp., 30 F.R.D. 32, 34 (E.D. Pa. 1962).

Upon reading the Complaint and the paragraphs at issue here, the Court determines that they are used in the context of providing background on YBM and are of such evidentiary quality that they should not be stricken. The paragraphs are not unduly prejudicial to defendant Bogatin; nor are they redundant, immaterial, impertinent or scandalous to warrant this Court to strike them from the Complaint. Accordingly, defendant Bogatin's request to strike said paragraphs is denied.

O R D E R

AND NOW, this            day of March, 2000, upon  
consideration of the following defendants' Motions to Dismiss,  
plaintiffs' Response thereto, and defendants' Reply briefs  
thereto, it is hereby ORDERED as follows:

(1) Defendants Harry Antes and Frank Greenwald's  
Motion Joining in Defendant Parente, Randolph, Orlando, Carey &  
Associates' Motion to Dismiss Claims of Canadian Plaintiffs on  
the Grounds of Comity is GRANTED.

(2) Defendant Parente, Randolph, Orlando, Carey &  
Associates' Motion to Dismiss Claims of Canadian Plaintiffs on  
the Grounds of Comity is DENIED.

(3) Defendant Parente, Randolph, Orlando, Carey &  
Associates' Motion to Dismiss pursuant to the Private Securities  
Litigation Reform Act of 1995 ("Reform Act") and Federal Rules of  
Civil Procedure 9(b) and 12(b)(6) is DENIED.

(4) Defendant R. Owen Mitchell's Motion to Dismiss  
Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 12(b)(6)  
and 12(b)(1) is DENIED.

(5) Defendant Deloitte & Touche LLP's Motion to  
Dismiss Plaintiff's Consolidated Amended Complaint pursuant to  
Fed.R.Civ.P. 12(b)(6) and the Reform Act is DENIED.

It is further ORDERED that defendant Deloitte &  
Touche's request for oral argument pursuant to Local Civil Rule  
7.1(f) is DENIED.

(6) Defendant David R. Peterson's Motion to Dismiss Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 12(b)(6) is DENIED.

(7) Defendants James J. Held's and Guy R. Scala's Motion to Dismiss Plaintiff's Consolidated Amended Complaint pursuant to Rule 12(b)(6) is DENIED.

(8) Defendants Harry Antes' and Frank Greenwald's Motion to Dismiss pursuant to Fed.R.Civ.P. 12(b)(1) and 12(b)(6) DENIED.

(9) Defendant Jacob Bogatin's Motion to Dismiss Consolidated Amended Complaint pursuant to Fed.R.Civ.P. 9(b) and 12(b)(6) is DENIED.

Defendant Bogatin's request to strike certain paragraphs from the consolidated Amended Complaint is DENIED.

(10) Defendant Daniel E. Gatti's Motion to Dismiss pursuant to Fed.R.Civ.P. 12(b)(6) and 12(b)(1) is DENIED.

AND IT IS SO ORDERED.

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Clarence C. Newcomer, S.J.