

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

IN RE: : CIVIL ACTION
: :
SAFEGUARD SCIENTIFICS : 01-3208
:

MEMORANDUM AND ORDER

JOYNER, J.

November 18th, 2004

Via the motion now pending before this Court, Defendants Safeguard Scientifics, Inc. and Warren V. Musser move for summary judgment pursuant to Fed. R. Civ. P. 56(b). Plaintiff's Complaint asserts two causes of action under Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j(b). For the reasons that follow, we will GRANT Defendants' Motion for Summary Judgment in its entirety.

Factual Background

Plaintiffs, investors in Safeguard Scientifics, Inc. (Safeguard), bring this Securities Exchange Act action alleging two bases of liability against Safeguard and its founder, Warren C. Musser.

Plaintiffs' omission claim, brought pursuant to Section 10(b) of the Securities Exchange Act, alleges that Defendants failed to disclose material items of information, and that Plaintiffs suffered significant financial losses as a result of their reliance on the incomplete information available to them. See 17 C.F.R. 240.10b-5(b); 15 U.S.C. §78j(b). Defendants

allegedly failed to disclose the fact that, beginning in December of 1999, Musser had pledged his holdings of Safeguard stock as collateral for personal margin trades, and that in September and October of 2000, Safeguard had extended Musser a \$10 million loan and a \$35 million guarantee. Plaintiffs allege that they suffered market losses as Safeguard stock prices fell in response to the disclosure of these facts in December of 2000 and February of 2001.

Plaintiff's market manipulation claim, also brought under Section 10(b), alleges that Defendants purchased stock in Safeguard's partner companies with the intent of inflating and fraudulently manipulating Safeguard stock prices. See 17 C.F.R. 240.10b-5; 15 U.S.C. §78j(b). Specifically, Plaintiff's claim focuses on allegedly manipulative purchases of eMerge Interactive stock made during the second quarter of 2000.

Summary Judgment Standard

The purpose of summary judgment under Federal Rule of Civil Procedure 56(c) is to avoid a trial in situations where it is unnecessary and would only cause delay and expense. Goodman v. Mead Johnson & Co., 534 F.2d 566, 573 (3rd Cir. 1976). A court may properly grant a motion for summary judgment only where all of the evidence before it demonstrates that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Celotex

Corp. v. Catrett, 477 U.S. 317, 322-32 (1986). A genuine issue of material fact is found to exist where "a reasonable jury could return a verdict for the non-moving party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986).

In deciding a motion for summary judgment, all facts must be viewed and all reasonable inferences must be drawn in favor of the non-moving party. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986). However, the party opposing the motion may not rest upon the bare allegations of the pleadings, but must set forth "specific facts" showing that there is a genuine issue for trial. Fed. R. Civ. P. 56(e); Celotex, 477 U.S. at 324.

Elements of a Section 10(b) Claim

To state a valid claim under Section 10(b) of the Securities Exchange Act, a plaintiff must show that (1) the defendant made a misrepresentation or omission of a material fact, (2) the defendant had knowledge of the falsity, (3) the plaintiff reasonably relied on this representation, and (4) the plaintiff's resulting loss was caused by his reliance on the representation. Hayes v. Gross, 982 F.2d 104, 106 (3rd Cir. 1992) (citing Shapiro v. UJB Fin. Corp., 964 F.2d 272, 280 (3rd Cir. 1992)); see also Semerenko v. Cendant Corp., 223 F.3d 165, 174 (3rd Cir. 2000).

Where the plaintiff's § 10(b) claim is grounded in the defendant's use of a manipulative or deceptive device, the

plaintiff must, rather than identifying a material misrepresentation or omission, show "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976). A plaintiff may establish such conduct by showing that the defendant either injected inaccurate information into the market or created a "false impression of market activity." GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 205 (3rd Cir. 2001). However, to maintain a private right of action for market manipulation, a plaintiff must still prove the basic elements of scienter, reliance, and causation of damages, typically reflected in stock price movements. GFL Advantage Fund, 272 F.3d at 206, n. 6; In re Bell Atl. Corp. Sec. Litig., 1997 U.S. Dist. LEXIS 4938, 92-93, 1997 WL 205709 (E.D. Pa. 1997)

I. Plaintiff's Market Manipulation Claim

We must grant Defendants' motion for summary judgment with respect to the § 10(b) market manipulation claim, as Plaintiffs have set forth no specific facts beyond the pleadings to satisfy the element of loss causation required to sustain such an action. The only evidence Plaintiffs have presented on the issue of loss causation was contained in an expert affidavit dated August 30, 2004, the relevant portions of which were stricken by this Court's Memorandum and Order dated November 17, 2004.

Defendants, on the other hand, have presented expert analysis concluding that their purchases of eMerge stock had no statistically significant impact on the price of Plaintiffs' Safeguard stock holdings. As nothing in the record presently before this Court indicates that Defendants' allegedly manipulative eMerge trades caused Plaintiffs' losses, we find that Plaintiffs cannot prevail on their market manipulation claim as a matter of law.

II. Plaintiff's Omission Claim

We likewise grant Defendants' motion for summary judgment with respect to the § 10(b) omission claim, as Plaintiffs have failed to show that Defendants were under any affirmative duty to disclose the information regarding Mr. Musser's margin trading and financial liabilities. Although a jury could find that the elements of materiality, causation, reliance have been satisfied, the deficiency in the threshold issue of duty is fatal to Plaintiff's claim.

Federal securities law imposes no general duty to disclose material information in connection with trading activities. Oran v. Stafford, 226 F.3d 275, 285 (3rd Cir. 2000). However, an affirmative duty to disclose will arise where a statute or rule requires such disclosure, where an insider or the stock issuer itself is engaged in trading, or where a prior disclosure is or becomes inaccurate, incomplete, or misleading. Oran, 226 F.3d at

285-286 (3rd Cir. 2000); see also Burekovitch v. Hertz, No. 01-1277, 2001 U.S. Dist. LEXIS 12173 at 25, 2001 WL 984942 (S.D. N.Y. 2001). Some courts have also held that misconduct amounting to market manipulation under Rule 10b-5 imposes an independent duty to disclose. In re Initial Public Offering Sec. Litig., 241 F.Supp.2d 281, 381 (S.D. N.Y. 2003). This disclosure duty is not implicated here, however, as Plaintiffs' market manipulation claim fails as a matter of law. Of the three remaining sources of duty identified by Plaintiffs, none impose a disclosure obligation in this case.

Plaintiffs first claim that Defendants were under a duty to disclose by virtue of the "abstain or disclose" rule, which requires insiders to disclose information on which they plan to act before they trade upon it. Deutschman v. Beneficial Corp., 841 F.2d. 502, 506 (3rd Cir. 1988). Plaintiffs suggest that Defendants were obligated to disclose Mr. Musser's "scheme" to purchase eMerge stock with the intent of inflating Safeguard stock prices, so that he could later sell his Safeguard shares at a significant profit. Even if this argument implicated the allegedly omitted information regarding Mr. Musser's margin trading, loan, and guarantee (which it does not), it fails because the present action is not an insider trading case. An insider's duty to disclose information under the narrow "abstain or disclose" rule is not transferrable to general securities

fraud claims, such as an omission claim brought under Section 10(b). See In re Seagate Tech. II Sec. Litig, 843 F. Supp. 1341, 1369 (N.D. Cal. 1994); Murphy v. Sofamor Danek Group, 123 F.3d 394, 403 (6th Cir. 1997); Anderson v. Abbott Labs, 140 F. Supp. 2d 894, 909-10 (N.D. Ill. 2001); Chan v. Orthologic Corp., No. 96-1514, 1998 WL 1018624 at 12 (D. Ariz. 1998). As Plaintiffs have not brought insider trading claims against Defendants, they may not rely on the "abstain or disclose" rule to impose a duty of disclosure in this case.

Plaintiffs further allege that Mr. Musser was under a duty to disclose his margin loan agreements pursuant to Section 13(d) of the Securities Exchange Act. 15 U.S.C. 78m(d). However, Mr. Musser is exempt from Section 13(d), as he acquired his Safeguard shares prior to December 22, 1970. Instead, Mr. Musser is governed by Section 13(g), which requires only that he disclose the number and description of the Safeguard shares in which he has an interest, the nature of such interest, and whether any other person has a right to receive proceeds from the sale of these shares. 15 U.S.C. 78m(g); 17 C.F.R. 240.13d-102. As Mr. Musser's pledges of Safeguard stock as collateral for his margin trading did not constitute a change in beneficial ownership for the purposes of Section 13(g), he was under no obligation to disclose his activities until he actually disposed of those shares at the end of 2000. 17 C.F.R. 240.13d-3(d)(3).

Finally, Plaintiffs claim that Defendants were bound by a duty to disclose information regarding Mr. Musser's financial status because their prior statements to the market were inaccurate or incomplete. See Kline v. First Western Government Secs., 24 F.3d 480, 491 (3rd Cir. 1994). Plaintiffs have identified a number of public statements and disclosures made throughout 1999 and 2000, all of which highlight Safeguard's strong market performance and express confidence in the company's future success. However, general reports of positive performance do not impose a disclosure duty unless they include an "affirmative characterization" placing the disputed information at issue. Oran, 226 F.3d at 284-85. None of the statements identified by Plaintiffs address the details of Mr. Musser's personal trading or touch on loans, guarantees, or other financial obligations assumed by Safeguard. Because this Court cannot identify a single public disclosure which affirmatively placed these issues "in play," Defendants were under no disclosure obligation with respect to these matters.

Significantly, at least one court has held that SEC and common law disclosure duties are not implicated where controlling shareholders pledge company stock as collateral for lawful margin trades. Burekovitch, 2001 U.S. Dist. LEXIS 12173 at 25-28. "While a controlling shareholder's decision to commit large quantities of his stock as security in margin trading undoubtedly

has the potential to affect the price of that stock, plaintiff has not and cannot allege an affirmative duty ... to keep the public apprised of such a decision." Burekovitch, 2001 U.S. Dist. LEXIS 12173 at 25. We find the United States District Court for the Southern District of New York's reasoning in Burekovitch highly persuasive, as it is consistent with this Court's position on disclosure duties relating to lawful short selling, expressed in GFL Advantage Fund, 272 F.3d at 213-14. In that case, this Court held that short sales executed in accordance with SEC rules and regulations do not impose disclosure duties on sellers, because such sales are lawful, legitimate transactions with "real buyers on the other side." GFL Advantage Fund, 272 F.3d at 214. We find that margin trading is a similarly heavily regulated activity which, if executed lawfully in an open market, does not create a false impression of supply and demand subjecting traders to independent disclosure requirements. Because Plaintiffs cannot point to an affirmative duty obligating Defendants to disclose information regarding Mr. Musser's margin trading, loan, and guarantee, Plaintiff's omission claim fails as a matter of law.

An appropriate Order follows.

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ORDER

AND NOW, this 18th day of November, 2004, upon consideration of Defendants' Motion for Summary Judgment (Doc. No. 62) and all responses thereto (Docs. No. 63, 65), it is hereby ORDERED that the Motion is GRANTED.

IT IS FURTHER ORDERED that JUDGMENT is ENTERED in the above action for Defendant and against Plaintiff.

BY THE COURT:

s/J. Curtis Joyner

J. CURTIS JOYNER, J.