UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

U.S. SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

HARBINGER CAPITAL PARTNERS LLC; PHILIP A. FALCONE; AND PETER A. JENSON,

Defendants.

ECF CASE

Case No. 12-CIV-5028

ORAL ARGUMENT REQUESTED

PHILIP A. FALCONE AND HARBINGER CAPITAL PARTNERS LLC'S MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Defendants Harbinger Capital Partners LLC ("Harbinger") and Philip A. Falcone (collectively, the "Harbinger Defendants") respectfully submit this memorandum of law in support of their motion to dismiss Plaintiff's Complaint (the "Complaint").[1]

I. PRELIMINARY STATEMENT

In an effort to justify its two-year long investigation into Mr. Falcone, Plaintiff has cobbled together a Complaint alleging that the Harbinger Defendants engaged in two entirely unrelated "fraudulent schemes." But the two alleged "schemes" consist of conduct that was entirely lawful, harmed no one and was expressly permitted under the Harbinger funds' governing legal documents.

The first "fraudulent scheme" relates to a $113 million loan (the "Loan") that Mr. Falcone obtained in October 2009 from the Harbinger Capital Partners Special Situations Fund ("SSF") to pay an unanticipated personal tax liability that a big four accounting firm failed to anticipate. The Loan was taken at the specific suggestion of Harbinger's outside counsel at Sidley Austin LLP ("Sidley")[2], including a lawyer who is an internationally recognized expert in the organization and operation of hedge funds.

Although Plaintiff alleges that Mr. Falcone "misappropriate[d]" the Loan proceeds, the Complaint acknowledges that the Loan was repaid in full at above-market interest in accordance with a Loan and Security Agreement (the "Loan Agreement") that Sidley drafted. Compl. ¶¶ 2, 40, 41, 43, 59. The Loan was disclosed five months later in the SSF's year-end audited financial statements, in accordance with Sidley's advice. *Id.* ¶¶ 19, 37, 39, 40. The Complaint does not allege that the Loan put the SSF at risk; to the contrary, the Loan was fully secured by Mr. Falcone's interest in the SSF (¶ 57)—an interest worth $233 million, more than twice the value of the Loan.

---

[1] The Harbinger Defendants adopt the arguments set forth in defendant Peter A. Jenson's Motion to Dismiss the Complaint to the extent they apply to the claims asserted against the Harbinger Defendants.

[2] Sidley is referred to in the Complaint as "Law Firm A". Compl. ¶ 16.

Nor did the Loan result in any investor losing money. In fact, because Sidley designed the Loan to have "atrocious economic terms" for Mr. Falcone, SSF investors *profited* from the Loan.

The second "fraudulent scheme" is likewise based on conduct that harmed no one and was permitted under the relevant Harbinger fund documents. Plaintiff alleges that, in March 2009, Harbinger entered into side letters with three investor representatives granting their clients "preferential liquidity" in exchange for an affirmative vote on a change to the redemption provisions of a separate Harbinger fund, the Harbinger Capital Partners Fund I ("HCP Fund I"). Compl. ¶ 64. But, so what? It is undisputed that ***Harbinger had the right under HCP Fund I's governing documents to grant preferential liquidity to select investors***, and the Complaint does not allege otherwise. Consequently, all HCP Fund I investors—who are among the most sophisticated investors in the world—knew that HCP Fund I could enter into the kinds of agreements that Plaintiff now seeks to describe as fraudulent. For this reason, Plaintiff resorts to alleging that the Harbinger Defendants failed to secure HCP Fund I Board approval for certain of the side letters and failed to disclose their terms to other investors. But the Complaint does not allege that Mr. Falcone was responsible for these administrative tasks or that the Harbinger Defendants personally benefited from the side letters. In fact, the Complaint acknowledges that the Harbinger Defendants proposed the change in HCP Fund I's redemption provisions to "stabilize" the fund, given that it had "experienced a sharp decline in assets under management" as a result of the "2008 credit crisis". *Id.* ¶¶ 60, 61. As in the Loan "scheme," no investors were harmed from this change to the fund's redemption provisions.

Based on these allegations, and in the absence of any of the traditional indicia of *scienter* typically seen in fraud cases, Plaintiff seeks to stretch the prohibitions in the federal securities laws to cover conduct that, to our knowledge, has never been the subject of any previous enforcement action. The claims against the Harbinger Defendants should be dismissed for the following reasons:

First, the Loan claims under Section 17(a), Section 10(b) and Rule 10b-5 are defective because the Complaint cannot allege that the Harbinger Defendants made any misrepresentations or omissions—or engaged in any other allegedly fraudulent conduct—"in connection with" the "offer or sale" or "purchase or sale" of securities. As the Complaint alleges, as a result of "potential claims in connection with the 2008 bankruptcy of the SSF's prime broker, a Lehman Brothers affiliate", the SSF was subject to a "lock-up" (the "Lock-Up") during the relevant period. Compl. ¶ 17. Because of the Lock-Up, SSF investors could not buy new shares in the fund or redeem the shares that they had already purchased—the fund was frozen. The Lock-Up remained in place from October 2008, one year *before* the Loan was made, through June 2010, three months *after* the Loan was disclosed. Compl. ¶¶ 17, 20. Thus, during the period in which the alleged fraud occurred, there were no purchases, no offers and no sales of any interests in the SSF, and none would have been possible given the facts alleged in the Complaint. In fact, no new investments were made in the SSF after October 2008. As a result—and as a matter of law—there can be no liability under Section 17(a), Section 10(b) or Rule 10b-5.

Second, and for similar reasons, the Loan claims under Section 17(a), Section 10(b), Rule 10b-5 and Sections 206(1), (2) and (4) (and Rule 206(4)-8 thereunder) must be dismissed because the Complaint fails to allege any material misrepresentations or omissions to SSF investors. Any communications about the Loan could not, as a matter of law, be considered "material" to SSF investors because the Lock-Up prevented those investors from making any investment decisions relating to the SSF. And even if SSF investors had been able to make investment decisions, any statements about the Loan would not be material because the Loan represented less than 5% of the SSF's total assets under management.

Third, claims relating to the alleged preferential liquidity "scheme" under Section 17(a)(1), Section 10(b), Rule 10b-5 and Section 206(1) must be dismissed because Plaintiff has failed to allege facts showing that the Harbinger Defendants—and in particular, Mr. Falcone—acted with the requisite *scienter*. The Complaint fails to allege that any defendant enjoyed any concrete or personal benefits from the alleged "scheme," or that they engaged in any conscious misbehavior or recklessness. The Complaint concedes that the "HCP Fund I governing documents allowed the fund to enter into side letters with investors," Compl. ¶ 85, but does not contain any allegations that Mr. Falcone had any responsibility for disclosing the side letters to the HCP Fund I Board of Directors or to HCP Fund I investors, or had any personal motive to conceal them.

Fourth, all of the preferential liquidity claims must be dismissed because Plaintiff has failed to allege any material misstatements or omissions to HCP Fund I investors, given that the HCP Fund I's governing documents expressly allowed redemption terms to be modified or waived for certain investors. Plaintiff has not plausibly alleged that any reasonable investor would have considered a further, specific disclosure of the alleged side letters to be important in making an investment decision. To the extent the preferential liquidity claims are based on an alleged failure to disclose to HCP Fund I's directors, the Complaint does not adequately allege that such disclosure was in fact required, or that any failure to disclose would have been important to a reasonable investor in light of the facts alleged in the Complaint.

This memorandum is structured as follows. In Part II, we describe the allegations of the Complaint, which, for purposes of this motion only, are taken as true. With respect to the Loan, we describe in Part II.A the extraordinary fact that the Loan was conceived, structured, described, and later defended by David Sawyier, a Sidley partner who is senior in the hedge fund and investment advisory group in that firm. With respect to the alleged preferential liquidity "scheme," we note in Part II.B the explicit language in the operative fund documents that provides for the very side letters Plaintiff cites as evidence of fraud. In Part III, we describe the legal standard applicable to this motion; and in Part IV we demonstrate why the Complaint fails to adequately allege claims for relief with respect to both the Loan (Part IV.A-B) and the alleged preferential liquidity "scheme" (Part IV.C-E).

II. FACTUAL BACKGROUND

Though Defendants dispute many of Plaintiff's allegations, for purposes of this motion, the Complaint's well-pleaded allegations are assumed to be true.

A. The Loan

1. Mr. Falcone's Advisors Discover An Unexpected Tax Liability And Are Unable To Find Alternative Sources Of Funds

Due to an accounting error and Mr. Falcone's "mistaken assumption" that Harbinger fund losses sustained during the 2008 market crash would offset his personal tax liabilities, Compl. ¶ 23, Mr. Falcone came to owe a "large tax payment due by October 2009." *Id.* ¶ 22. By July 2009, "the amount due had risen to more than $100 million." *Id.* ¶ 24.

Defendants considered several options to resolve Mr. Falcone's large and unexpected personal tax liability. For example, Defendants contacted bank officials about a loan in August 2009, *id.* ¶ 28, considered borrowing against Mr. Falcone's personal assets, *id.* ¶ 30, and considered accessing Mr. Falcone's deferred compensation, *id.* ¶ 27. Ultimately, none of these efforts proved successful.

2. Sidley Suggests A Loan From The SSF To Falcone

"[F]ollowing discussions with a partner at [Sidley]" (David Sawyier), Peter Jenson—Harbinger's Chief Operating Officer—presented Mr. Falcone with the idea of "taking a loan from SSF using [Mr. Falcone's] SSF interest, rather than other personal assets, as collateral." *Id.* ¶ 34.

After Mr. Falcone expressed interest in the idea of a loan, Sidley prepared a draft term sheet (the "Term Sheet") and emailed it to Mr. Jenson. *Id.* ¶ 35.[3] Sidley "never contacted Falcone" but

---

[3] The Term Sheet is identified in Paragraph 35 of the Complaint and referenced throughout the Complaint. It is proper for the Court to consider the Term Sheet—and the other documents "incorporated by reference" in the Complaint—on a motion to dismiss. *See DiFolco v. MSNBC Cable L.L.C.*, 622 F.3d 104, 111 (2d Cir. 2010) (in considering a motion to dismiss, a district court may consider "the facts alleged in the complaint, documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint….Where a document is not incorporated by reference, the court may nevertheless consider it where the complaint 'relies heavily upon its terms and effect,' thereby rendering the document 'integral' to the

communicated with other Harbinger personnel, including Mr. Jenson, about the proposed Loan. *Id.* ¶ 36. Following these communications, Sidley provided a draft memorandum (the "Sidley Memo") to Harbinger, which advised that "it is reasonable for [Harbinger] to conclude that the Loan is *consistent with Harbinger's fiduciary duty to the [SSF] Fund.*" *Id.* ¶ 37 (emphasis added).[4] Sidley then "condensed the [Sidley Memo] into a PowerPoint" (the "PowerPoint"), Compl. ¶ 38, which Mr. Falcone, Mr. Jenson, and Harbinger's in-house counsel reviewed during a meeting on October 9, 2009, *id.* ¶ 39. Following Mr. Falcone's determination that the Loan indeed was consistent with Harbinger's fiduciary duty to the SSF, Sidley finalized the Loan Agreement in consultation with Mr. Jenson. *Id.* ¶ 40.[5]

3. Sidley Structures The Loan In The Best Interests Of SSF Investors

In light of Mr. Falcone's "fiduciary relationship" with the SSF, the Sidley Memo advised that the Loan's terms should make "absolutely clear that the Loan is structured in the best interests of the fund." Dontzin Decl. Ex. 2 at 3. In fact, Sidley described the proposed Loan as having "atrocious economic terms" for Mr. Falcone. *Id.*

Thus, Sidley structured the Loan "to have no downside, and potentially significant upside, to investors." Dontzin Decl. Ex. 1. The Loan had "no downside" because it was over-collateralized by Mr. Falcone's interest in the SSF, Compl. ¶ 41, which was worth $233.4 million as of October 15, 2009.[6] This represented a significant over-collateralization of more than 200% of the $113.2 million Loan amount. *See id.* ¶ 16. If the value of Mr. Falcone's SSF interest declined to 125% of the

---

complaint."). A copy of the Term Sheet is attached as Exhibit 1 to the accompanying Declaration of Matthew S. Dontzin (the "Dontzin Decl.").

[4] A copy of the Sidley Memo is attached as Exhibit 2 to the Dontzin Decl.

[5] A copy of the Loan Agreement is attached as Exhibit 3 to the Dontzin Decl.

[6] *See* the SSF's audited financial statements (page 38), which are referred to in Paragraph 19 of the Complaint and attached as Exhibit 4 to the Dontzin Decl.

outstanding Loan balance—or if any other enumerated "Event of Default" occurred—the SSF had the right to declare the Loan "immediately due and payable." Dontzin Decl. Ex. 3 §§ 6.01; 6.02.

The Loan had "potentially significant upside" for two reasons. First, it featured an interest rate of "the higher of (i) the Applicable Federal Rate plus one percent (1%) per annum and (ii) the Lender's actual cost of funds as determined by the Lender in its reasonable discretion plus one percent (1%) per annum." *Id.* § 1.01. This interest rate would be adjusted *upwards* every six months if necessary, but never downwards. *Id.* In addition, interest payments would be allocated to all SSF investors other than Mr. Falcone, so that Mr. Falcone would not receive any interest income in connection with the Loan. *Id.* § 1.04.

Second, the Loan featured an "equity enhancement" component giving other SSF investors the benefit of any increase in value—but no risk of any decline in value—of Mr. Falcone's interest in the fund. *Id.* § 1.08. As with the interest payments, any benefit from the "equity enhancement" component would be allocated to SSF investors other than Mr. Falcone. *Id.*

In sum, Sidley designed the Loan "to protect and benefit the Fund"—and, by extension, SSF investors—"to the maximum practicable extent." Dontzin Decl. Ex. 2 at 3.

4. The Loan Was Permitted Under The SSF's Partnership Agreement

The Complaint does not allege that the Loan itself violated any laws, or that the SSF was not authorized to loan money to Mr. Falcone. In fact, the SSF's Amended and Restated Agreement of Limited Partnership, dated as of August 1, 2006 (the "LPA"), granted the SSF the unlimited right to: "lend, either with or without security, any Securities, *funds*, or other properties of the Partnership . . . ." (Emphasis added).[7] LPA § 2.02(i).

[7] The LPA is referred to in Paragraph 18 of the Complaint and attached as Exhibit 5 to the Dontzin Decl.

5. The Loan Is Used To Pay Mr. Falcone's Tax Obligation, Is Disclosed To SSF Investors In Accordance With Sidley's Advice And Is Promptly Repaid

Pursuant to the Loan Agreement, the Loan was made on October 15, 2009, just in time to meet the IRS deadline of October 15. Compl. ¶¶ 41, 44. The full $113.2 million Loan amount was "used to pay Falcone's personal tax liability," *id.* ¶ 44, and the Complaint does not allege that the money was used for any other purpose.

In the Term Sheet and in the Sidley Memo, Sidley advised that "the Loan should not be a special disclosure matter for investors. The Loan will, in the ordinary course, be disclosed in the footnotes of the Lender's financial statements." Dontzin Decl. Ex. 1 at 3; Dontzin Decl. Ex. 2 at Schedule-4. Defendants followed Sidley's advice and disclosed the Loan to investors in the SSF's audited financial statements on March 10, 2010, less than five months after the Loan was made. Compl. ¶ 19. During those five months, no purchases or sales of SSF investments occurred or could have occurred.

The Loan was repaid in full in March 2011, *id.* ¶ 59, well in advance of its original maturity date. Mr. Falcone paid an interest rate of 3.66% on the Loan, *id.* ¶ 43, and investors earned an even higher effective rate because any interest earned on Mr. Falcone's SSF holdings was reallocated to the other investors. The Complaint does not allege that SSF investors suffered any harm whatsoever as a result of the Loan.

B. The Alleged Preferential Liquidity "Scheme"

The Complaint's second set of allegations relates to a March 2009 change in the redemption provisions for a separate Harbinger fund, HCP Fund I. Harbinger and Mr. Falcone allegedly entered into "side deals" to give "some of their largest investors . . . preferential liquidity in return for an affirmative vote" on the new provisions. Compl. ¶ 64.

The Complaint does not allege that this conduct was inherently unlawful, but instead asserts that the agreements were "concealed" and not disclosed to HCP Fund I investors. *Id.* ¶ 65. As explained below, however, the Complaint also concedes that such "side letters" were permitted under the relevant governing documents. *Id.* ¶ 85.

1. Defendants Propose A Change In HCP Fund I's Redemption Terms To "Stabilize" The Fund After The 2008 Credit Crisis

HCP Fund I allowed investments to be redeemed on specified dates each calendar quarter. Compl. ¶ 61. Until March 2009, HCP Fund I had a "fund-level gate," which permitted up to 20 percent of the fund's total assets to be redeemed on a given redemption date. *Id.* ¶ 61. If investors' redemption requests exceeded this 20 percent threshold on a given redemption date, all investors would receive pro-rated redemptions for the quarter and unfulfilled redemption requests would be fulfilled on a pro-rata basis with available liquid assets in subsequent quarters.

Many hedge funds experienced investment losses in 2008, and as a result, many investors were seeking to redeem their interests. *See id.* ¶ 60. In early 2009, to "try to stabilize the situation"—i.e., to minimize the risk of non-liquidity for non-redeeming investors—Harbinger and Mr. Falcone "proposed a change" to a "more restrictive investor-level gate." *Id.* ¶¶ 61, 62. Under the investor-level gate, each investor would be limited to redeeming 25 percent of its total investment in the fund in any fiscal quarter. *Id.* This ensured that HCP Fund I could not be compelled to sell all of its liquid assets on a rolling basis to meet redemption requests, thereby preserving liquidity for non-redeeming investors.

The Complaint does not allege that the Harbinger Defendants personally benefited from the proposed change to an investor-level gate.

2. Defendants Obtain Investor Consent In A Manner Permitted Under The Governing Documents

The proposed change required investor consent. *Id.* ¶ 63. The Complaint alleges that Harbinger and Mr. Falcone granted "preferential liquidity" to three large investors "in return for an affirmative vote." *Id.* ¶ 64. The "preferential liquidity" was allegedly granted through "side letters," "compulsory" redemptions, and waiving a 90-day notice provision otherwise applicable to redemption requests. *Id.* ¶¶ 67-68, 71, 78, 80.

Significantly, the Complaint concedes that "HCP Fund I governing documents *allowed* the fund to enter into side letters with investors." *Id.* ¶ 85 (emphasis added). More specifically, HCP Fund I's governing documents—which are incorporated by reference into the Complaint—allow HCP Fund I's feeder funds' advisor and board of directors to "waive or modify the conditions relating to [redemptions]" for "certain large or strategic investors." Dontzin Decl. Ex. 6 § 8.02(d) (Fund I LPA); Dontzin Decl. Ex. 7 ¶ 27(a) (Offshore Fund I Articles of Association). In other words, the governing documents not only permitted side letters, but expressly allowed redemption requirements to be waived or modified for "large or strategic investors."

3. The Complaint's Disclosure-Based Allegations

Because the Complaint cannot allege that the side letters or other grants of "preferential liquidity" were inherently unlawful, it instead asserts that the alleged "scheme" was "concealed" from other investors and the HCP Fund I's board of directors. Compl. ¶ 3.

The Complaint, however, does not allege that disclosure to the HCP Fund I's board of directors was in fact required. Nor does the Complaint allege that any Harbinger Defendant had a personal motive to conceal the side letters from anyone; that any Harbinger Defendant had an improper purpose in encouraging investors to consent to the investor-level gate proposal (which, in fact, worked to the benefit of non-redeeming HCP Fund I investors as it provided the manager with a tool to stabilize and manage liquidity); that the votes allegedly connected to the "side deals" were necessary for the gate proposal to pass; or that any investor experienced any losses as a result of the purported "scheme."

C. Plaintiff's Claims

With respect to both alleged "schemes" outlined above, Plaintiff asserts claims against the Harbinger Defendants under: (1) Section 17(a) of the Securities Act of 1933; (2) Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder; (3) Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act"); and (4) Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Plaintiff also asserts a control person claim against Mr. Falcone under Section 20(a) of the Exchange Act.

III. LEGAL STANDARD

A complaint "must contain sufficient factual matter, accepted as true, to state a claim for relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation and quotation marks omitted). To make this showing, a complaint may not rely on naked assertions without supporting facts. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557 (2007). "A pleading that offers 'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.'" *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 555). Rather, the Complaint must plead "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*

IV. ARGUMENT

A. The Loan Claims Under Section 10(b), Rule 10b-5 And Section 17(a) Must Be Dismissed Because The Complaint Fails To Allege Any Misrepresentations Or Omissions In Connection With The Offer, Purchase Or Sale Of Securities

To "state a claim under section 10(b) of the 1934 Act . . . and Rule 10b-5 promulgated thereunder . . . Plaintiff must plead that the defendant '(1) made a material misrepresentation or a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter;

(3) *in connection with the purchase or sale of securities*.'" *SEC v. Czarnik*, No. 10 Civ. 745 (PKC), 2010 WL 4860678, at *3 (S.D.N.Y. Nov. 29, 2010) (emphasis added) (quoting *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999)). "Essentially the same elements are required under Section 17(a)(1)-(3) in connection with the *offer* or sale of a security, though no showing of scienter is required for the SEC to obtain an injunction under subsections (a)(2) or (a)(3)." *Monarch Funding Corp.*, 192 F.3d at 308 (emphasis added).

Here, the Complaint concedes that no SSF interests were offered, purchased, or sold during the relevant period because the SSF was subject to the Lock-Up. Compl. ¶¶ 17, 20. Because the Complaint fails to allege—and, as a result of the Lock-Up, cannot allege—any offers to purchase, purchases or sales of interests in the SSF during the relevant period, the Complaint fails to state a claim for relief relating to the Loan under Section 10(b), Rule 10b-5 or Section 17(a). *See, e.g.*, *Rand v. Anaconda-Ericsson, Inc.*, 794 F.2d 843, 847 (2d Cir. 1986) ("To fall within Section 10(b), misrepresentations must have some direct pertinence to a securities transaction."); *SEC v. Norton*, No. 95 Civ. 4451 (SHS), 1997 WL 611556, at *6 (S.D.N.Y. Oct. 3, 1997) ("Because the alleged fraudulent misrepresentations involved in the escrow transactions here were not made in connection with the purchase, offer or sale of a security, the SEC has failed to state a claim under the antifraud securities laws with respect to this initial transaction.").

In its October 9, 2012 Pre-Motion Conference Letter ("Pre-Motion Letter"), Plaintiff did not dispute that the Complaint fails to allege any offers to purchase, purchases or sales of interests in the SSF. Instead, Plaintiff argued that: (1) the Loan itself qualifies as a security; and (2) Mr. Falcone pledged his interest in the SSF as collateral for the Loan (the "Pledge") and that this Pledge "is deemed to be in connection with the offer and sale of a security for the purposes of Section 17(a) and Section 10(b)." Both arguments fail.

Plaintiff's arguments in its Pre-Motion Letter overlook the purpose of the federal securities laws, which is to "protect persons who are deceived in securities transactions – to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be." *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir. 1984). *See also Nay ex rel. Thiele v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., No. 05 Civ. 10264 (RMB), 2006 WL 2109467, at *3 (S.D.N.Y. July 25, 2006) (recognizing Section 10(b)'s "fundamental purpose of requiring full and fair disclosure to *participants in securities transactions*") (emphasis added).

Here, the persons that Plaintiff alleges were deceived about the Loan were *investors* in the SSF—and the only relevant "transactions" they could participate in were purchases or sales of *their interests in that fund*. As a result, the only securities relevant to the "in connection with" analysis are interests in the SSF.

In any event, Plaintiff's argument fails because: (1) the Loan is not a security; and (2) the Complaint does not allege any misrepresentations or omissions "in connection with" the Pledge.

1. The Loan Is Not A Security

a. The Loan Was Not Designed To Be Traded Publicly

The Supreme Court held in *Marine Bank v. Weaver*, 455 U.S. 551 (1982) that a private agreement between two parties entered into as consideration for a loan was not a security. In reaching its decision, the Supreme Court observed that Congress did not intend the securities laws to cover private agreements "not designed to be traded publicly":

> Congress intended the securities laws to cover those instruments ordinarily and commonly considered to be securities in the commercial world, but the agreement between the Weavers and the Piccirillos is not the type of instrument that comes to mind when the term "security" is used and does not fall within "the ordinary concept of a security." . . . *The unusual instruments found to constitute securities in prior cases involved offers to a number of potential investors, not a private transaction* as in this case. In *Howey*, for example, 42 persons purchased interests in a citrus grove during a 4-month period. In *C.M. Joiner Leasing*, offers to sell oil leases were sent to over 1,000 prospects. In *C.M. Joiner Leasing*, we noted that a security is an instrument in which there is "common trading." *The instruments involved in C.M.*

> *Joiner Leasing and Howey had equivalent values to most persons and could have been traded publicly.* Here, in contrast, the Piccirillos distributed no prospectus to the Weavers or to other potential investors, *and the unique agreement they negotiated was not designed to be traded publicly.*

Id. at 559-560 (emphasis added) (citations omitted). Here, as in *Marine Bank*, the Loan is a private transaction that was memorialized by a unique agreement—the Loan Agreement—and was not designed to be traded publicly.

b. The Loan Is Not A "Note" Or An "Investment Contract"

In its Pre-Motion Letter, Plaintiff cited *Reves v. Ernst & Young*, 494 U.S. 56 (1990) and *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) for the proposition that the Loan should be considered a security. Neither case, however, supports the expansive and unprecedented view of the federal securities laws Plaintiff advances here.

In *Howey*, the Supreme Court held that certain "investment contracts" could be considered securities. The Court explained that "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298-299. The "investment contract" test plainly indicates that the Loan is not a security. The SSF did not invest in a "common enterprise;" it merely loaned money to Mr. Falcone to pay his "state and federal taxes." Compl. ¶ 16.

In *Reves*, the Supreme Court discussed whether "notes" can be considered securities within the meaning of the federal securities laws. *Reves* does not apply for the basic reason that no note was signed in connection with the Loan Agreement.

c. The Loan Is Not A "Security" Under *Reves*

Even if the Loan could somehow be considered a "note", it still would not be considered a security under *Reves.* In *Reves*, the Supreme Court cautioned that in enacting the securities laws, "Congress was concerned with regulating the investment market, not with creating a general federal cause of action for fraud." 494 U.S. at 65. Thus, "[w]hether notes are to be considered securities . . . turns on whether the notes have been issued in an investment context, in which case they are securities, or whether they have been issued in a commercial or consumer context, in which case they are not." *Benedict v. Amaducci*, No. 92 Civ. 5239 (KMW), 1995 WL 413206, at *8 (S.D.N.Y. July 12, 1995) (citing *Reves*). Here, to the extent the Loan could even be considered a "note", it certainly was not issued in an "investment context" because its sole purpose was to allow Mr. Falcone to pay his taxes.

In *Reves*, the Supreme Court articulated four factors to be evaluated to determine whether a note (outside certain enumerated types not relevant here) should be considered a security: (1) "the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]"; (2) "the 'plan of distribution' of the instrument"; (3) "the reasonable expectations of the investing public"; and (4) "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." 494 U.S. at 66-67 (internal citations omitted).

An analysis of the four factors demonstrates that the Loan should not be considered a "security" under the securities laws. *Benedict v. Amaducci*, No. 92 Civ. 5239 (KMW), 1995 WL 413206 (S.D.N.Y. July 12, 1995) is instructive here. In *Amaducci*, the individual defendants allegedly engaged in fraudulent self-dealing by borrowing millions of dollars from a set of family trusts, annuities and businesses, on the basis of alleged misrepresentations. 1995 WL 413206 at *3. The plaintiffs loaned money to the defendants by purchasing "notes" from several entities with which the defendants were associated. *Id.* at *8. Defendants then used the proceeds of these notes for various consumer purposes, including, for example, as collateral to extend the term of construction loans, to refinance a mortgage, and to meet obligations on certain loans. *Id.* at *9.

After considering the *Reves* factors, Judge Wood concluded that the notes at issue were not "securities." First, she stated, "[e]ach of the notes in this case was apparently issued as a result of [defendant's] difficulties in raising cash to meet its various obligations . . . the seller's purpose was not to raise money for the general use of a business but rather to meet immediate cash obligations." *Id.* The second and third *Reves* factors also supported the conclusion that the notes were not "securities" because plaintiffs "[did] not allege any 'plan of distribution' for the notes, and there was no public expectation that the notes would be traded as securities." *Id.* at *10.

The same analysis applies here: (1) the Loan was issued to meet Mr. Falcone's immediate cash obligations, (2) Plaintiff does not allege any "plan of distribution" for the Loan[8] and (3) there was no public expectation that the Loan would be traded as a security. In addition, the fourth *Reves* factor, the presence of a significant risk-reducing factor, also counsels against the Loan's being treated as a security, because the Loan was fully secured by Mr. Falcone's interest in the SSF. *See, e.g.*, *Bass*, 210 F.3d at 585 ("the fourth factor again mitigates against these notes being securities, since, as applied in *Reves*, the existence of collateral is significant as a risk-reducing factor").

2. The Pledge Does Not Satisfy The "In Connection With" Requirement

As explained above, the Loan is not a "security" within the meaning of the federal securities laws. Plaintiff cannot overcome this deficiency by arguing that the Pledge somehow satisfies the requirement that the alleged misstatements or omissions be made "in connection with the purchase or sale of a security."

Rubin v. United States, 449 U.S. 424 (1981), cited in Plaintiff's Pre-Motion letter, is inapposite. In *Rubin*, the borrower's misrepresentations related to the pledged securities—the borrower's shares of stock. *Id.* at 426-27. The *Rubin* Court expressly declined to "decide whether misrepresentations or omissions involved in a securities transaction but not pertaining to the securities themselves can form the basis of a violation of § 17(a)." *Id.* at 429 n.6.

[8] *See, e.g.*, *Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 585 (6th Cir. 2000) ("[t]he second factor, the plan of distribution, tilts against the notes being securities, since the transaction was unique, negotiated with a single buyer and negotiated term by term, rather than being offered in a wholesale or potentially wholesale fashion.").

Three years later, in *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir. 1984), the Second Circuit held that alleged misrepresentations or omissions *that do not pertain to the pledge of securities themselves* cannot form the basis for liability under Section 10(b), Rule 10b-5, or § 17(a). The Second Circuit stated that "it is not sufficient to allege that a defendant has committed a proscribed act in a transaction of which the pledge of a security is a part," *id.* at 943 (emphasis added); *see also Anatian v. Coutts Bank (Switzerland) Ltd.*, 193 F.3d 85, 88 (2d Cir. 1999) (quoting *Chemical Bank* and rejecting plaintiffs' attempt "to transform what are in essence breach of contract claims or breach of fiduciary duty claims only tangentially involving securities into securities fraud claims.").

Here, with two arguable exceptions (discussed below), the Complaint does not allege that the Harbinger Defendants made any misrepresentations or omissions about the Pledge. Instead, the Complaint alleges various "misrepresentations and omissions to investors *concerning the SSF loan* to Falcone."[9] Compl. ¶ 49 (emphasis added).[10] Because none of these allegations relates to the Pledge itself, none is sufficient to satisfy the "in connection with" requirement under Section 10(b) or Section 17(a). *See, e.g., Rand v. Anaconda-Ericsson, Inc.*, 794 F.2d 843, 847 (2d Cir. 1986) (the "incidental involvement of securities as collateral" does not "by itself implicate the anti-fraud provisions of the federal securities laws").

[9] Specifically, the Complaint alleges that "Harbinger sent monthly SSF portfolio holdings reports to certain SSF investors" that "failed to include *the loan*", *id.* ¶ 50 (emphasis added); that Mr. Falcone "told an investor that other key investors were aware of *the loan*", *id.* ¶ 51 (emphasis added); that Harbinger "investor relations personnel" failed to disclose the Loan in communications with SSF investors, *id.* ¶ 52; that "talking points" used by "Harbinger investor relations personnel for use in responding to investor inquiries" contained misstatements about why Mr. Falcone needed the Loan, when he learned of his tax obligations and the role of outside counsel in vetting the Loan, *id.* ¶¶ 53, 54; and that in a September 29, 2010 email to an investor representative, Mr. Falcone falsely stated that the Loan was "vetted extensively with outside counsel" and failed to disclose that the Defendants did not follow outside counsel's "advice to treat *the loan* as a fund investment," *id.* ¶¶ 57, 58 (emphasis added).

[10] The Complaint also alleges that "Jenson and Harbinger [but not Mr. Falcone] concealed and misrepresented facts in communications" with Sidley. Compl. ¶ 46. But the Complaint does not —and cannot in light of the Lock-Up—allege that any of these alleged misrepresentations or omissions were made in connection with the offer, purchase or sale of a security. Thus, these alleged misrepresentations and omissions cannot give rise to liability on the part of the Harbinger Defendants.

The Complaint contains two allegations that the Harbinger Defendants misrepresented the amount of the collateral supporting the Loan. The Complaint alleges that on March 16, 2010, defendant Jenson emailed "talking points" to Harbinger's investor relations personnel for use in responding to investor inquiries, in which "Jenson and Harbinger described the amount of collateral supporting the loan as being 15 times the amount of the loan, when, in fact, the collateral coverage was less than 2 times." Compl. ¶ 54. Critically, the Complaint does *not* allege that these talking points were ever conveyed to any investor. The Complaint also alleges that in a September 29, 2010 email to an unidentified "investor representative", Mr. Falcone stated falsely that the Loan "was collateralized by all my holdings, essentially 14x." *Id.* ¶ 57.

These two alleged misstatements are not sufficient to satisfy the "in connection with" requirement because they were both made long after the Pledge was made when the Loan Agreement was signed on October 14, 2009. In *S.E.C. v. Zandford*, 535 U.S. 813, 822 (2002), the Supreme Court held that to satisfy the "in connection with" requirement the "scheme to defraud and the sale of securities" must "coincide." In *Zandford*, the defendant broker engaged in a "fraudulent scheme in which he made sales of his customer's securities for his own benefit." *Id.* at 820. The court held that the scheme satisfied the "in connection with" requirement because the "securities sales and respondent's fraudulent practices were not independent events . . . each sale was made to further respondent's fraudulent scheme." *Id.* at 820.

Here, the two alleged misrepresentations about the Pledge did not coincide with that securities transaction; to the contrary, the misrepresentations were made months after the Pledge was made. Accordingly, these two statements cannot satisfy the "in connection with" requirement under Section 10(b) or Section 17(a). *See, e.g., In re JWP Inc. Sec. Litig. v. Dwyer*, 928 F. Supp 1239, 1253 (S.D.N.Y. 1996) ("Misrepresentations made after the purchase or sale in question cannot satisfy the 'in connection with' requirement."); *Goldman v. McMahan, Brafman, Morgan & Co.*, No. 85 Civ 2236 (PKL), 1987 WL 12820, at *8 (S.D.N.Y. June 18, 1987) ("To meet the 'in connection with' requirement, the 'fraud practiced must have been prior to or contemporaneous with the sale of securities.'") (citations omitted).[11]

In sum, because the Loan is not a security and the alleged misrepresentations and omissions do not relate to the Pledge, the Loan claims under Section 10(b), Rule 10b-5 and Section 17(a) fail the "in connection with" requirement for liability.

B. The Complaint Fails To Allege Any Material Misrepresentations Or Omissions About The Loan

Plaintiff's Loan claims under Section 10(b), Rule 10b-5 and Section 17(a)—as well as Plaintiff's Loan claims under Section 206(1) and (2) of the Advisers Act, and Section 206(4) and Rule 206(4)-8 thereunder[12]—must be dismissed because the Complaint does not—and cannot—allege any *material* misrepresentations or omissions to SSF investors about the Loan.

For misstatements or omissions to be considered material, Plaintiff must show that a reasonable investor would have considered them important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). Here, because of the Lock-Up, no SSF investor could make *any* investment decisions—either to buy new shares in the fund or to redeem his or her

[11] In addition, the two alleged misrepresentations cannot give rise to any liability because they were made after the Pledge was accurately disclosed in the SSF's audited financial statements on March 12, 2010, and thus were not material. As the audited financial statements disclosed, "[t]he Loan is secured by a first priority security interest in the Borrower's entire direct and indirect equity interest in the Lender, including both his direct limited partnership interest and his indirect interest, through his partial ownership of the General Partner, in the Lender (collectively, the "Collateral"). . . . As of October 15, 2009, the value of the Collateral was approximately $233.4 million (approximately 206% of the Principal Amount) . . . ." Dontzin Decl. Ex. 4 at 38. *See City of Roseville Employees' Ret. Sys. v. Energy Solutions, Inc.*, 814 F.Supp.2d 395, 410 (S.D.N.Y. 2011) ("In determining whether an allegedly false statement or omission of fact is material, the Court looks at whether there is a substantial likelihood that a statement or omission significantly altered the *total mix of information made available*, as viewed by the reasonable investor.") (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)) (emphasis added) (quotation marks omitted).

[12] The materiality requirement applies to all of Plaintiff's disclosure-related claims under the Advisers Act. *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 201 (1963) (noting, in action under Section 206(1) and (2), that Advisers Act requires "disclosure of material facts"); *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992) (liability may be imposed for violations of Section 206(2) "only if the omitted disclosures were material"); *SEC v. Nutmeg Grp., LLC*, No. 09 Civ. 1775, 2011 WL 5042094, at *3-4 (N.D. Ill. Oct. 19, 2011) (under Section 206(4) and Rule 206(4)-8 the "untrue statements must be material, meaning that a reasonable investor would consider the statement important") (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988)).

interests—during the period the Loan was not disclosed. Under these unique circumstances, any statements or omissions made by Harbinger Defendants about the Loan are immaterial as a matter of law.

The Seventh Circuit's decision in *LHLC Corporation v. Cluett, Peabody & Co.*, 842 F.2d 928 (7th Cir. 1988) is instructive here. In *LHLC*, the buyer of a department store chain asserted a Section 10(b) claim against Deloitte, Haskins & Sells ("Deloitte"), the seller's accountant, based on its provision—after the closing of the sale—of an allegedly false report overvaluing the seller's inventory. 842 F.2d at 932. The district court concluded that any misstatements in Deloitte's report "were not 'material' because they did not affect LHLC's decision to close the transaction". *Id.* at 931. The Seventh Circuit affirmed, holding that even if the information in Deloitte's report was "conventionally 'material,'" that information could not constitute the basis for a Section 10(b) claim because it "did not affect the investment decision." *Id.* The court explained:

> [T]he appropriate inquiry is whether the information disclosed or withheld affected an *investment* decision . . . . The securities laws single out investment decisions concerning financial instruments from among many decisions people must make . . . Information about these instruments should be compiled and released by a single source, usually the issuer, to facilitate trading among passive investors and the ability to compare the prospects of one firm against the prospects of others – a comparison essential if capital is to flow to its most valuable uses. *If a person is locked into possession of a security,* however, disclosure serves neither of these functions . . . .

Id. at 931-932 (initial emphasis in original; second emphasis added).

For the same reasons, any statements or omissions about the Loan cannot be considered material, given that SSF investors were locked into possession of their interests in the SSF as a result of the Lock-Up and had no ability to make any investment decisions during the relevant period. *See also SEC v. Goble*, 682 F.3d 934, 934-935 (11th Cir. 2012) (The test "for materiality in the securities fraud context is whether a reasonable man would attach importance to the fact misrepresented or omitted in determining his course of action . . . We understand this course of action to mean an investment decision") (citation and quotation marks omitted); *SEC v. Pirate Investor LLC*, 580 F.3d

233, 340 (4th Cir. 2009) ("[A] fact stated or omitted is material if there is a substantial likelihood that a reasonable purchaser or seller of a security (1) would consider the fact important in deciding whether to buy or sell the security"); *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 (10th Cir. 1997) ("A statement or omission is only material if a reasonable investor would consider it important in determining whether to buy or sell stock.").

The fact that the Loan represented a relatively small fraction of the SSF's total assets under management further counsels against materiality. In *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2d Cir. 2009), the defendants allegedly violated the securities laws by mischaracterizing $2 billion worth of transactions in their financial disclosures. *Id.* at 203-204. The Second Circuit stated that "[a]lthough $2 billion . . . may sound staggering, the number must be placed in context . . . changing the accounting treatment of approximately 0.3% of [defendant's] total assets . . . would not have been material to investors." *Id.* at 204 (quotations and citation omitted).

Here, the "SSF had approximately $2.4 billion in assets as of December 31, 2009," Compl. ¶ 15, and therefore the $113.2 million Loan constituted approximately 4.7% of the fund's total assets. This small percentage "does not suggest materiality," *ECA, Local 134*, 553 F.3d at 204, *especially* in light of the Lock-Up and the fact that the terms of the Loan were so favorable to investors.[13] *See also Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 547 (8th Cir. 1997) (finding alleged misrepresentations with regard to two percent of total assets were immaterial as a matter of law); *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 715 (3d Cir. 1996) (stating that a misstatement was immaterial where less than one percent of assets was allegedly misclassified).[14]

---

[13] *See, e.g.*, *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 200 (2d Cir. 2009) (dismissing Section 10(b) claim in part because shareholders benefited from the alleged fraud).

[14] In its Pre-Motion Letter, Plaintiff also argued that the Loan was "material" because, during the period the Loan was not disclosed, the Harbinger Defendants "asked SSF investors to vote on two restructuring

C. The Preferential Liquidity Claims Under Section 17(a)(1), Section 10(b), Rule 10b-5 And Section 206(1) Must Be Dismissed Because The Complaint Fails To Adequately Plead *Scienter*

To plead *scienter*, Plaintiff must allege facts that give rise to a "strong inference" of fraudulent intent. *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994). This "strong inference" may be established "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." *Id.* (citations omitted). The Complaint's allegations with respect to the alleged preferential liquidity "scheme" fail to satisfy either prong of this test.

To satisfy the "motive and opportunity" prong, Plaintiff must allege that the Harbinger Defendants "benefitted in some *concrete* and *personal* way from the purported fraud." *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009) (emphasis added). The Complaint contains no such allegations. The Complaint alleges that the "preferential liquidity scheme" was implemented to assure a favorable vote on a proposed change to HCP Fund I's redemption provisions. Compl. ¶ 64. But that proposal was not made to provide any concrete or personal benefits to the Harbinger Defendants. To the contrary, as the Complaint recognizes, the Harbinger Defendants proposed the change to the HCP Fund I's redemption provisions to "stabilize the situation" resulting from a "sharp decline in assets under management" following "the 2008 credit crisis." Compl. ¶¶ 60, 61.

The Complaint alleges that an unidentified "Harbinger employee" stated in an email that "it will look bad" if the proposal was not approved by HCP Fund I investors. Compl. ¶ 63. That allegation is not sufficient to establish *scienter* on the part of the Harbinger Defendants because it does not establish that they benefitted in any "concrete and personal" way from the alleged fraud.

---

proposals." Compl. ¶ 21. But the Complaint does not and cannot allege that these proposals called for any investment decisions by SSF investors.

See ECA, Local 134, 553 F.3d at 198 ("[m]otives that are common to most corporate officers, such as the desire for the corporation to appear profitable . . . do not constitute 'motive' for purposes of [pleading *scienter*]"); *In re Moody's Corp. Sec. Litig.*, 599 F.Supp.2d 493, 515 (S.D.N.Y. 2009) (granting defendant's motion to dismiss because "the preservation of reputation [does not] constitute a cognizable motive for fraud.").

If a plaintiff cannot show "motive and opportunity," then it may raise a "strong inference" of *scienter* by alleging "strong circumstantial evidence" of conscious misbehavior or recklessness, although the absence of improper motive means that the "strength of the circumstantial allegations must be correspondingly greater." *ECA, Local 134*, 553 F.3d at 199. "*Scienter* based on conscious misbehavior . . . requires a showing of deliberate illegal behavior . . . a standard met when it is clear that a scheme, viewed broadly, is necessarily going to injure." *Gould v. Winstar Communications, Inc.*, 692 F.3d 148, 158 (2d Cir. 2012) (citations and quotation marks omitted). "*Scienter* based on recklessness may be demonstrated where a defendant has engaged in conduct that was 'highly unreasonable, representing an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.' Recklessness may be established where a defendant 'failed to review or check information that [it] had a duty to monitor, or ignored obvious signs of fraud.'" *Id.* at 158-59.

The Complaint does not allege that the Harbinger Defendants engaged in any "deliberate illegal behavior" or conduct that was "highly unreasonable, representing an extreme departure from the standards of ordinary care" in connection with the preferential liquidity "scheme." To the contrary, the Complaint's allegations establish that the Harbinger Defendants were motivated to "stabilize the situation" for HCP Fund I investors, Compl. ¶ 61, and that the HCP Fund I Board ratified certain of the side letters that Plaintiff alleges were not disclosed to investors. Compl. ¶¶ 70, 78. As noted above, the Complaint also acknowledges that the HCP Fund I's governing agreements allowed side letters, and those agreements (which were available to all investors in HCP Fund I) further state that preferential liquidity terms were permitted.

A finding that Mr. Falcone himself acted with *scienter* would be especially unwarranted here. The Complaint fails to allege that Mr. Falcone *himself* benefitted in any "concrete and personal" way from the failure to disclose the side letters to the HCP Fund I Board or to investors, let alone that he engaged in any "deliberate illegal behavior" or "reckless conduct." In fact, the Complaint fails to allege that Mr. Falcone had *any* responsibility whatsoever for disclosing the side letters or that he had any motive to conceal them, much less enjoyed any concrete or personal benefit from doing so.[15]

D. All Of The Preferential Liquidity Claims Must Be Dismissed On Materiality Grounds

As noted in Part IV.B, Section 10(b), Rule 10b-5 and Section 17(a) require material misrepresentations or omissions. Plaintiff's claims under the Advisers Act are also subject to a materiality requirement to the extent they are premised on misstatements or omissions. *See* n.11, *supra*.

All of the preferential liquidity claims must be dismissed on materiality grounds. The Complaint acknowledges that side letters were permitted under HCP Fund I's governing documents, and those documents expressly allowed redemption terms to be modified or waived for certain investors. *Supra* at Part II.B.2. In light of the governing documents, Plaintiff has not plausibly alleged that any reasonable investor would have considered a further, specific disclosure of the alleged side letters to be important in making an investment decision. *Cf. Basic*, 485 U.S. at 231-32.

---

[15] Plaintiff also asserts a control person claim against Mr. Falcone under Section 20(a) of the Exchange Act. This claim fails because Plaintiff has not established a primary violation of Section 10(b). *See ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 108 (2d Cir. 2007) ("To establish a prima facie case of control person liability, a plaintiff must show (1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud.").

The investor vote itself was not an investment decision, and in any event the Complaint does not allege that the alleged *quid pro quo* actually altered the outcome of the vote. Finally, to the extent the preferential liquidity claims are based on an alleged failure to disclose to the HCP Fund I's directors, *cf*. Compl. ¶ 3, the Complaint does not adequately allege that such disclosure was in fact required, or that any failure to disclose would have been important to a reasonable investor in light of the facts described above.

V. CONCLUSION

For all the foregoing reasons, the Harbinger Defendants' motion to dismiss should be granted.

Dated: New York, New York
November 30, 2012

THE DONTZIN LAW FIRM LLP

/s/Matthew S. Dotnzin
Matthew S. Dontzin
David A. Fleissig
Tibor L. Nagy, Jr.
Rachel K. Clapp
6 East 81st Street
New York, New York 10028
Tel: (212) 717-2900
Fax: (212) 717-8088

Attorneys for Defendant Philip A. Falcone

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

Leslie Gordon Fagen
1285 Avenue of the Americas
New York, NY 10019
Tel: (212) 373-3000
Fax: (212) 757-3990

Attorneys for Defendant Harbinger Capital Partners LLC