1999 WL 544708
United States District Court, S.D. New York.

GLOBAL INTELLICOM, INC., Plaintiff,
v.
THOMSON KERNAGHAN & CO.; Bronia Gmbh; Augustine Fund, L.P.; Sovereign Partners, L.P.; Atlantis–Capital Fund, Ltd.; Mark Valentine; Stephen Hicks; JNC Opportunity Fund, Ltd; Encore Capital Management, L.L.C.; Neil T. Chau; James A. Skalko; Frederick A. Lenz; Spratt Family Trust; James W. Spratt, Ill; and Susan M. Spratt, Defendants.

No. 99 CIV 342(DLC). | July 27, 1999.

Attorneys and Law Firms

Alfred R. Fabricant, Fabricant & Yeskoo, LLP, New York, NY, for plaintiff.

Hilary Richard, Brune & Richard LLP, New York, NY, for defendants Thomson Kernaghan & Co., Ltd., Sovereign Partners, L.P., Atlantis Capital Fund, Ltd., Mark Valentine, and Stephen Hicks.

Eric Rieder, Robinson Silverman Pearce, Aronsohn & Berman LLP, New York, NY, for defendants JNC Opportunity Fund Ltd., Encore Capital Management, LLC, and Neil Chau.

Joel M. Wolosky, Parker Chapin Flattau & Klimpl, LLP, New York, NY, for defendant James A. Skalko.

Lyndon M. Tretter, Davis Weber & Edwards P.C., New York, NY, for defendant Bronia GmbH.

OPINION AND ORDER

COTE, J.

***1** Plaintiff Global Intellicom, Inc. ("Global") filed this action on January 18, 1999, and filed an Amended Complaint on February 9, 1999. The Amended Complaint alleges twenty-nine causes of action, including violations of Sections 9(e), 10(b), 13(d), 16(a)—(c) of the Securities Exchange Act of 1934 ("Exchange Act"), and common law fraud and contract. A majority of the defendants remaining in this action have now filed motions to dismiss.[1] On March 19, 1999, defendants Thomson Kernaghan & Co., Ltd., Sovereign Partners, L.P., Atlantis Capital Fund, Ltd., Mark Valentine, and Stephen Hicks (collectively, the "Thomson Defendants") filed a motion to dismiss all of the claims against them. On March 22, 1999, defendants JNC Opportunity, Encore Capital, and Neil T. Chau (collectively the "JNC Defendants") also moved to dismiss all of the claims against them. On April 13, 1999, defendant Bronia GmbH filed a motion to dismiss all of the claims against it. Finally, on May 3, 1999, individual defendant James A. Skalko filed a motion to dismiss all of the claims against him. For the reasons stated, the motions are denied in part and granted in part.

BACKGROUND

The Amended Complaint alleges the following facts.[2] Global is a Nevada corporation with its principal place of business in New York. Global was incorporated in September 1994 and completed a public offering of its stock in September 1995. Global was listed for trading on the NASDAQ SmallCap in May 1996. Initially, Global provided limited-area network design and certified low voltage computer and video transmission cabling, as well as a wide range of computer systems integration and information technology staffing services to corporate and government entities. Global was also a manufacturer and seller of custom built computers with reseller licenses from a number of computer industry leaders, the Department of Defense, and the General Services Administration. In 1997, Global decided to discontinue less profitable divisions and focus on the two successful divisions—systems integration and personal computers. To raise money, Global undertook a series of offerings of convertible preferred stock and debentures.

Defendants are the purchasers of several series of these securities. With respect to all of the defendants, Global alleges that they have engaged in a pattern of improper activity that can be summarized as follows. Global alleges that the terms of the securities gave the defendants the incentive to engage in a number of improper practices to drive down the price of Global common stock. Although the defendants represented at the time they acquired the securities that they would not engage in such practices, the defendants engaged in a series of schemes, including short selling, to depress the value of Global common stock and artificially increase trading volume. Defendants are thereby alleged to have abused the conversion rights they acquired to cover short positions, reap improper profits, and receive a disproportionate number of shares at the time of conversion.

Thomson Defendants and Bronia

***2** The Thomson Defendants are constituted as follows. Defendant Thomson Kernaghan & Co. ("Thomson") is a Canadian corporation and a registered broker/dealer. Defendant Sovereign Partners, L.P. ("Sovereign") is a Canadian limited partnership, whose limited partners are not listed in the complaint. Defendant Atlantis Capital Fund, Ltd. ("Atlantis") is a Canadian corporation. Individual defendant Mark Valentine is a Canadian resident. He is alleged to have been a Vice President and Director of Thomson and to have acted as an agent for defendants Bronia, Sovereign, and Atlantis when they purchased convertible preferred shares. Individual defendant Stephen Hicks is a resident of Connecticut and is alleged to be a controlling person of defendant Sovereign. Defendant Bronia GmbH ("Bronia") is a Bahamian corporation.

The Thomson Defendants purchased a number of different series of convertible preferred stock. In December 1997, Global initiated an offering of 2,200 shares of Series 6 Convertible Preferred Stock, each share having a liquidation value of $1,000. Along with other buyers, on December 23, 1997, Global and Thomson executed a "Private Placement Offering Subscription Agreement and Questionnaire" ("Series 6 Agreement") for the purchase of 1,000 Series 6 shares. Bronia executed an identical Series 6 Agreement also for the purchase of 1,000 shares. Section 6.1.3. of each Series 6 Agreement contains the following provision:

> Conversion: Beginning on the 60th day after the date of the Closing (the "Conversion Commencement Date"), each share of Preferred Stock purchased in such Closing will be convertible into shares of the Company's Common Stock at a per-share conversion price which will be equal to 75% of the five-day average closing bid price per-share of Common Stock immediately prior to the date of conversion by each holder.

Similar language is contained in the Global Series 6 Certificate of Designation. The result of this conversion calculation is that a decrease in the price of Global common stock prior to conversion results in a greater number shares of common stock for the holder on conversion. The plaintiff alleges that the conversion formula creates a strong incentive to leverage that discount and engage in the following selling practices: (1) short selling (selling shares not yet owned and covering the sale with shares to be acquired at a lower price), (2) selling against the box (selling shares owned but not yet able to be delivered), and (3) flipping (selling the stock to be received in the conversion immediately prior to or after the conversion).

The Series 6 Agreements contain the following representation (the "Investment Representation") by the purchaser at Section 3.3.1:

> Investment: No Distribution Scheme: Ability to Bear Risk: The Subscriber is acquiring the shares of Preferred Stock solely for investment purposes for the Subscriber's own account (or for beneficiaries' accounts over which the Subscriber has investment discretion but no discretionary authority as to voting or disposition) and not with a view to a distribution of all or any part thereof. *The Subscriber has no intention of arranging or engaging in, whether directly or indirectly or alone or with others, a plan or scheme to promote or facilitate selling short the shares of the Company's Common Stock, and Subscriber specifically agrees that Subscriber will not utilize the Preferred Stock being purchased hereunder or the Common Stock issuable upon conversion thereof to facilitate or participate in such a scheme.*The Subscriber has the financial ability to bear the economic risk of its investment for an indefinite period of time. The Subscriber has adequate means of providing for its current needs, anticipated contingencies, and has no need for liquidity of the investment. The Subscriber's commitment to illiquid investment is reasonable in relation to its net worth.

***3** (Emphasis supplied.) Under Section 9.2 of the Series 6 Agreement, this Investment Representation was to survive and continue after the delivery of the preferred.

In August 1998, Global agreed with Thomson and Bronia to place a short term limitation on the conversion privileges, since expired, for the Series 6 preferred. In exchange, each party received 300 shares of Series 11 Convertible preferred. On August 7, 1998, Thomson and Bronia each executed a "Private Placement Subscription Agreement and Questionnaire" for the Series 11 Convertible Preferred (each a "Series 11 Agreement"). Each Series 11 Agreement contains the following conversion provision:

> Conversion: Beginning on the 30th day after the date of the Closing (the "Conversion Commencement Date"), 50% of the Preferred Stock purchased in such Closing will be convertible into shares of the Company's Common Stock. The remaining 50% shall be convertible no earlier than November 15, 1998. Conversion shall be at a per share conversion price of Common Stock immediately prior to the date of conversion of each holder....

The Series 11 Certificate of Designation contains similar language. Once again, Global argues that this conversion formula gave the purchasers an incentive to depress the price of Global stock. The Series 11 Agreement also contains the same Investment Representation, quoted above, as was contained in the Series 6 Agreement, again with a survival of representation provision.

During this same period, Global sought to raise additional capital by issuing Series 10 Convertible Preferred Stock. On August 7, 1998, both Atlantis and Sovereign executed a "Private Placement Subscription Agreement and Questionnaire" for the Series 10 Preferred Stock (each a "Series 10 Agreement"). As with the previous series, Section 6.1.3 of the Series 10 Agreement contained the following conversion provision:

> Conversion: Beginning on November 15, 1998, or at any time upon notice form the Company, (the "Conversion Commencement Date"), each share of Preferred Stock purchased in such Closing will be convertible into shares of the Company's Common Stock at a per-share *conversion price which will be equal to 75% of the five-day average closing bid price per-share of Common Stock immediately prior to the date of conversion* by each holder.

(Emphasis supplied.) A corresponding provision is contained in the Series 10 Certificate of Designation. As before, Global alleges that this conversion formula created an incentive for Atlantis and Sovereign to drive down the price of Global common stock. The Series 10 Agreement contains, at Section 3.3.1, the same Investment Representation quoted above along with the survival of representation provision. Plaintiff alleges that Bronia and the Thomson Defendants conducted very little due diligence in connection with the execution of the Series 6, 9, and 10 Agreements.

James A. Skalko

Individual defendant James A. Skalko is a resident of the state of Florida. In or about January 1998, Global sought to raise additional capital by selling shares of Series 7 Convertible Preferred Stock with a liquidation value of $1,000. On February 3, 1998, Global and Skalko executed a "Private Placement Offering Subscription Agreement and Questionnaire" for Series 7 ("Series 7 Agreement") pursuant to which Skalko purchased 50 shares with a total liquidation value of $50,000. Both the conversion formula for the Series 7 and the Investment Representation are identical to those contained in the Series 6 Agreement. Once again, Global alleges that this created the incentive to depress the price of Global common stock.

JNC Defendants

***4** JNC Opportunity Fund, Ltd. ("JNC") is a Cayman Islands corporation with its principal place of business in Bermuda. Defendant Encore Capital Management L.L.C. ("Encore"), of unknown citizenship, is listed as JNC's investment advisor in connection with the transactions that are the subject of this action. Individual defendant Neil T. Chau is a Managing Director of Encore who signed agreements on behalf of JNC and Encore.

In April 1998, Global decided to raise additional capital by offering $2 million of 6% Convertible Debentures due April 30, 2001 (the "Convertible Debentures"). On April 30, 1998, JNC executed a Convertible Debenture Purchase Agreement

("Debenture Agreement"). The conversion language is not quoted in the Amended Complaint, but on conversion of the debentures, JNC is to receive common stock equal to $2 million plus accrued interest, divided by the lower of (a) 110% of the Global common stock average closing price as of the date the Convertible Debentures were issued, or (b) 80% of the average of the five lowest sale prices for Global common stock during the twenty-five days immediately preceding the conversion date. Global alleges that this conversion formula also gave JNC the incentive to depress the price of Global's common stock.

Nonetheless, Global alleges that it sought a representation with respect to short selling similar to the Investment Representation from JNC and that JNC refused to provide such a representation. Still, Global alleges that Chau, acting on behalf of JNC, made an oral representation to Global in a telephone conversation that JNC would not short sell or manipulate the market in Global stock. Global also alleges that JNC "represented in writing", that it was "acquiring the Securities for its own account for investment purposes only and not with a view to or for distributing or reselling such Securities or any part thereof or interest therein...." JNC is also alleged to have represented that it "is able to bear the economic risk of an investment in the Securities and, at the present time, is able to afford the loss of such investment." [3]

In October 1998, JNC executed an Exchange Agreement back dated to August 31, 1998, through which JNC exchanged the Convertible Debentures for 2,706 shares of a new Series 12 Convertible Preferred. Under the Exchange Agreement, at the time of conversion of the Series 12 Convertible Preferred, JNC was to receive 2,706,000 shares of common stock divided by the lower of (a) 1.1812 or (b) 75~~f the closing per-share bid price of Global common stock. Global alleges that this new conversion formula perpetuated the incentive to depress the price of Global's common stock, and that JNC conducted little or no due diligence on Global.~~

Global alleges that defendant JNC inserted the following provision at Section 3.8 of the Debenture Agreement to protect it from Exchange Act reporting requirements:

> Purchase Ownership of Common Stock. *The Purchaser agrees not to convert Debentures ... to the extent such conversion or exercise would result in the Purchaser beneficially owning (as determined in accordance with Section 13(d) of the Exchange Act and the rules thereunder) in excess of 4.999% of the then issued and outstanding shares of Common Stock,* including shares issuable upon conversion of the Debentures and exercise of the Warrants held by such Purchaser after application of this Section. To the extent that the limitation contained in this Section applies, the determination of whether Debentures are convertible (in relation to other securities owned by a Purchaser) and of which portion of the principal amount of such Debentures are convertible shall be in the sole discretion of the Purchaser, and the submission of Debentures for conversion shall be deemed to be such Purchaser's determination of whether such Debentures are convertible (in relation to other securities owned by a Purchaser) and of which portion of such Debentures are convertible, in each case subject to such aggregate percentage limitation, and the Company shall have no obligation to verify or confirm the accuracy of such determination. *Nothing contained herein shall be deemed to restrict the right of the Purchaser to convert Debentures or exercise the Warrants at such time as such conversion will not violate the provisions of this Section.The provisions of this Section* will not apply to any conversion pursuant to Section 4(a)(ii) of the Debentures, and *may be waived by the Purchaser upon not less than 75 days prior notice to the Company, and the provisions of this Section shall continue to apply until such 75th date (or later, if stated in the notice of waiver).*

***5** (Emphasis supplied.) Global alleges that a substantially similar provision was included in the Exchange Agreement with JNC.

Allegations of Market Manipulation

Global alleges that during this period, all of the defendants, beginning in early 1998 and continuing through the end of 1998, began to manipulate the market for Global common stock in order to reap short-term profits and increase the amount of common stock received on conversion, using the short-selling, boxing, and flipping techniques described above. Global states that

> Defendants at various times used this market activity to facilitate massive short-selling ... at various times in the wake of stock price depressing activities, demanded that [Global] convert their respective Preferred Stock for a large block of common stock ... at various times after various Defendants converting [sic] their preferred stock through boxing or other activities, permitting them to make additional profits in selling any remaining shares obtained through the conversion at 75% of the depressed price.

Although some conversions by other defendants are alleged in the complaint, Thomson, Sovereign, Atlantis, Bronia, JNC, and Skalko are only alleged "at various times" *to have attempted* to convert the Convertible Preferred into common stock. They are also alleged to have refused to reveal their short positions or make appropriate filings under the Exchange Act. One defendant involved in the present motions, James Skalko, is alleged to have "admitted to [Global] management that [he] had sold [Global] common stock short and ... needed the conversion stock to cover short positions."

Global also alleges that certain defendants have carried out similar manipulation schemes against other public companies. Specifically, the Thomson Defendants have purchased stock in approximately ten companies during 1997 and 1998, the price of whose stock then sharply decreased. At least three of those purchases resulted in litigation against them by the companies. The complaint lists and describes each of the transactions. Bronia is also alleged to have participated in one of these purchases. Only one alleged transaction involves JNC. JNC is alleged to have purchased $3,500,000 of convertible debentures from a Delaware corporation, the price of whose common stock then dropped sharply.

Market Activity in Global Common Stock

With respect to its common stock, Global alleges that prior to the issuance of the Series 6 Preferred in November 1997, the average daily trading volume of Global common was 44,000 with an average closing bid price of $2.26. By contrast, in January through March 1998, the average daily trading volume in Global common stock rose to approximately 75,000 shares per day. The price of Global common declined during this period and closed at $1.44 on March 31, 1998. On April 3, 1998, the closing bid price rose to $2.84 and the trading volume doubled, reaching a level of 1,507,100 shares.

***6** During this same period, short-selling skyrocketed. Short interest is alleged to have risen from *7 shares* in November 1997 to *162,257 shares* in March 1998. Since March 1998, the following short sales were reported in Global stock: 320,016 for May 1998, 312,610 for June 1998, and 255,404 for July 1998. Global also alleges that the defendants or their affiliates engaged in additional unreported short selling through Canadian stock-brokerage firms.

During this period, Global market capitalization shrank from approximately $16 million in April 1998 to a low of $4 million. Global common reached a low of $.63 a share on July 8, 1998. Global alleges that trading volume surged on July 31, 1998, August 7, 1998, and September 17, 1998, around the time that the Series 10, 11, and 12 Agreements became effective. Global alleges that its business was improving during this time. Finally, NASDAQ notified Global of its intent to delist its common stock from NASDAQ SmallCap Market and did so on October 22, 1998, based on the decline in per-share price and the dilutive effect of the issuance of the Convertible Preferred Stock. Since then, Global's common stock has traded on the Over–the–Counter Bulletin Board, reaching a new low $0.41 per share by December 1998.

DISCUSSION

This Court may grant a motion to dismiss pursuant to Rule 12(b)(6) only if "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."*Cohen v. Koenig,* 25 F.3d 1168, 1172 (2d Cir.1994) (quoting *Conley v. Gibson,* 355 U.S. 41, 45–46 (1957)). In considering a motion to dismiss, the Court must take "as true the facts alleged in the complaint and draw[ ] all reasonable inferences in the plaintiff[s'] favor." *Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.,* 32 F.3d 697, 699–700 (2d Cir.1994). In other words, the court can dismiss claims only if, assuming all facts as true, the claimant still has failed to plead the basic elements of his causes of action.

ISection 10(b)

The first three causes of action allege that the Thomson Defendants, Skalko, and JNC and Chau engaged in misrepresentation and market manipulation in violation of Section 10(b) of the Exchange Act. Each claim is somewhat tailored to the agreement and representation allegedly made by the defendant, but the theory of each claim is the same. With respect to the misrepresentation aspects of the claim, Global alleges that each of the defendants intended to engage in short selling and other improper practices at the time of purchase of the convertible securities, that each falsely represented that it would not engage in such practices, that the representation was material and relied on by Global in the issuance of the convertible securities, and that Global was injured as a result. In addition, the complaint alleges that the defendants engaged in market manipulation, including short selling, boxing, and flipping.

***7** Section 10(b) of the Exchange Act provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). Rule 10b–5 more specifically delineates what constitutes a manipulative or deceptive device or contrivance. *Press v. Chemical Inv. Servs. Corp.,* 166 F.3d 529, 534 (2d Cir.1999).

Rule 10b–5 is interpreted to require the following for a plaintiff to maintain a misrepresentation claim:

> "in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff's reliance on defendant's action caused [plaintiff] injury ."

Id. (quoting *In re Time Warner Secs. Litig.,* 9 F.3d 259, 264 (2d Cir.1993)) (brackets in original). The "in connection with" requirement is interpreted broadly "to mandate only that the act complained of somehow induced the purchaser to purchase the security at issue."*Press,* 166 F.3d at 537.

With respect to market manipulation claims, market manipulation

> is and was virtually a term of art when used in connection with securities markets. It connotes 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 manipulation claim under Section 10(b) has the following elements: (1) damages, (2) caused by reliance on defendants' misrepresentations or omission of material fact, or on a scheme by the defendants to defraud, (3) scienter, (4) in connection with the purchase or sale of securities, (5) furthered by the defendants' use of the mails or any facility of a national securities exchange. *See, e.g.,Schnell v. Conseco, Inc.,* 43 F.Supp.2d 438, 448 (S.D.N.Y.1999).

Section 10(b) and Rule 10b–5 require a plaintiff to prove that the defendant acted with scienter. *SeePress,* 166 F.3d at 537. The Private Securities Litigation Reform Act of 1995, P.L. 104–67 (the "Reform Act"), added a new Section 21D to the Exchange Act, that heightened the pleading requirement for scienter to that long applied in the Second Circuit, *Press,* 166 F.3d at 538, requiring a plaintiff to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."15 U.S.C. § 78u–4(b)(2). As the Second Circuit recently explained,

> [t]he element of scienter, as used in connection with the securities fraud

> statutes, requires a plaintiff to show that the defendant acted with intent to deceive, manipulate or defraud, or at least knowing misconduct. Whether a given intent existed generally is a question of fact.

***8** *Grandon v. Merrill Lynch & Co., Inc.,* 147 F.3d 184, 194 (2d Cir.1998) (internal citations omitted). Therefore,

> [a]s a pleading requirement, a plaintiff must either (a) allege facts to show that defendants had both motive and opportunity to commit fraud, or (b) allege facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.

Press, 166 F.3d at 538 (internal quotations omitted).*See also**Stevelman v. Alias Research, Inc.,* 174 F.3d 79, 84 (2d Cir.1999). In addition, a fraud claim under Section 10(b) must meet the requirement of Rule 9(b), Fed.R.Civ.P., that a plaintiff

> (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.

Id. (internal quotation omitted).

In market manipulation claims, courts have more relaxed pleading requirements, since "market manipulation claims present circumstances in which the mechanism of the scheme is likely to be unknown to the plaintiffs."*In re Bleich Securities Litigation (Bleich I),* 928 F.Supp. 1279, 1290–91 (S.D.N.Y.1996).*See also**In re Bleich Securities Litigation (Bleich II),* 961 F.Supp. 569, 580 (S.D.N.Y.1997). In such situations, courts have only required the plaintiff to lay out the "nature, purpose, and effect of the fraudulent conduct and the roles of the defendant" without requiring specific instances of the conduct.*Bleich I,* 928 F.Supp. at 1291. *See also**Dietrich v. Bauer,* 95 Civ. 7051(RWS), 1999 WL 126438, at *20 (S.D.N.Y. Mar. 10, 1999). In assessing whether an alleged scheme amounts to actionable conduct, the subjective intent of the trading activity is relevant. *United States v. Mulheren,* 938 F.2d 364, 368 (2d Cir.1991); *United States v. Regan,* 937 F.2d 823, 829 (2d Cir.1991).

A.Thomson Defendants

The Thomson Defendants make a barrage of arguments in favor of dismissal of the Section 10(b) claim against them. To begin with, they argue that Global lacks standing to bring a manipulation claim. With respect to Global's misrepresentation claim, the Thomson Defendants argue that (1) the complaint fails adequately to plead scienter, and (2) the allegations of transaction causation are insufficient. [4]

1.Standing

A private right of action under Section 10(b) is limited to actual purchasers and sellers. *See**Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 730–31 (1975); *Birnbaum v. Newport Steel Corp.,* 193 F.2d 461, 463–64 (2d Cir.1952). An issuer may not maintain a claim for damages under Section 10b–5 unless it is a purchaser or seller of securities. *Frankel v. Slotkin,* 984 F.2d 1328, 1334 (2d Cir.1993). Similarly, since the Supreme Court's decision in *Blue Chip,* the Second Circuit has not authorized an action for injunctive relief unless the complainant was a purchaser or seller of securities. *Compare**Mutual Shares Corp. v. Genesco, Inc.,* 384 F.2d 540, 547 (2d Cir.1967) (pre-*Blue Chip* decision permitting minority shareholders to maintain a market manipulation claim for injunctive relief).*But see**Langner v. Brown,* 913 F.Supp. 260, 270 (S.D.N.Y.1996) (regarding *Genesco* rule as "well-established").

***9** Global has standing to bring a misrepresentation claim in connection with its initial issuance of preferred shares, which constitutes a sale of securities for the purposes of Section 10(b).*Frankel,* 984 F.2d at 1334. To the extent that Global is alleging a separate market manipulation claim, Global has no standing to bring such a claim since it does not allege that it purchased or sold securities in connection with the alleged manipulation.

2.Scienter

The Thomson Defendants also argue that the first claim fails adequately to plead scienter with respect to misrepresentation. Specifically, the Thomson Defendants argue that contractual breach, by itself, does not constitute fraud based on the Second Circuit's decision in *Mills v. Polar Molecular Corp.,* 12 F.3d 1170, 1176 (2d Cir.1993). Nonetheless, *Mills* only stands for the unremarkable proposition that a breach of contract by itself is insufficient to meet the scienter requirement. *Id.* Here, the Amended

Complaint alleges that, at time of entering into the Series 6, 10, and 11 Agreements, the Thomson Defendants possessed an intent to engage in short selling and other practices that they represented to Global they would not do. This is a sufficient allegation of fraudulent intent. *Id.* (Breach of contract by itself "does not constitute fraud unless, when the promise was made, the defendant secretly intended not to perform or knew that he could not perform.").

Beyond the contractual representation, there are several other indicia of scienter that are sufficient to meet the standard quoted above and recently reiterated by the Second Circuit in *Press,* which requires a plaintiff to show either "motive and opportunity" to commit fraud or "facts that constitute strong circumstantial evidence" of conscious misbehavior or recklessness.*Press,* 166 F.3d at 538 (internal quotation omitted). Global alleges that the economics of the conversion ratio gave the Thomson Defendants an incentive to engage in short-selling and that they had the opportunity to complete such trades without detection. Global has also alleged the existence of circumstantial evidence such as the pattern of the Thomson Defendants' investments in other companies and the surges in the price and trading volume in Global stock. Coupled with the Investment Representation, Global has met its burden of pleading scienter under either prong of *Press.*

3.Causation

The Thomson Defendants allege that Global has failed adequately to plead either transaction causation or loss causation, both of which are required in any claim under Section 10(b).*Weiss v. Wittcoff,* 966 F.2d 109, 111 (2d Cir.1992). Thus, Global must show both that the defendants' misrepresentations caused Global to sell the preferred stock to the defendants and that those sales caused the harm that Global has suffered. *Id.*

> While transaction causation requires only a "but for" allegation, whether loss causation has been alleged turns upon a question of proximate cause: was the damage complained of a foreseeable result of the plaintiff's reliance on the fraudulent misrepresentation?

***10** *Id.* (internal citations omitted). The transaction causation requirement is met where the defendant is alleged to misrepresent a material fact. *Press,* 166 F.3d at 539. The loss causation requirement is met where the complaint alleges that the plaintiff's loss was a proximate result of reliance on the defendants' misrepresentations, even where those misrepresentations are as to future actions. *Weiss,* 966 F.2d at 111.

The Amended Complaint alleges that the Investment Representation was material and that Global "justifiably and reasonably relied to its detriment and has suffered substantial harm as a result."Other sections of the Amended Complaint indicate that Global actively sought and obtained the Investment Representation. Although this meets the transaction causation requirement, it is insufficient to meet the loss causation requirement. Plaintiff's boilerplate pleading of "substantial harm" does not relate at all to the misrepresentation in connection with the sale of the preferred stock. Plaintiff has failed to allege a cognizable injury that was proximately caused by the misrepresentations. As result, the Section 10(b) claim must be dismissed against the Thomson Defendants for failure to plead loss causation.

B.Bronia and Skalko

Bronia and Skalko join in the motion made by the Thomson Defendants. For those same reasons, the first claim is dismissed against Bronia, and the second claim is dismissed against Skalko.

C.JNC and Mr. Chau

In the third cause of action, Global alleges that it was reasonable to rely on an oral misrepresentation by Chau in April 1998 that JNC would not engage in short selling, and that its reliance on this misrepresentation caused it to sell the Convertible Debentures to JNC. [5] In response to this claim, JNC and Chau argue that: (1) a manipulation claim may not be maintained by Global, and (2) Global could not have reasonably relied on the alleged representation.

For the reasons discussed above, to the extent that it is attempting to assert a separate manipulation claim, Global does not have standing to bring such a claim against JNC. With respect to the remaining misrepresentation claim, the Court agrees that any reliance on the representation by Global would be unreasonable. Before proceeding further, it is worth noting that JNC is differently situated from the other defendants in this action, at least regarding the misrepresentation claim, since JNC did not make the same Investment Representation that it would not engage in short selling in either the Debenture Agreement or the Exchange Agreement.

Reasonable reliance is an element of a claim under Section 10(b), and may be appropriately considered by a Court on a motion to dismiss, where the absence of reliance is established by the terms of the agreement between the parties.*Harsco v. Segui,* 91 F.3d 337, 342 (2d Cir.1996). In determining whether reliance is reasonable in light of an agreement by the parties disclaiming reliance on certain kinds of representations, the Court

> ***11** is to compare the language in [the disclaimers] to the representations which [plaintiff] claims are fraudulent, keeping in mind the arms' length nature of the negotiation and the sophistication of the parties. The purpose in making this comparison is to determine whether once [plaintiff] entered into the Agreement, it became unreasonable to rely on the allegedly fraudulent representations.

Id. at 345.

The Amended Complaint alleges that JNC refused to make a specific representation in either the Debenture Agreement or the Exchange Agreement that it would not engage in short-selling. Instead, among the specific representations made in the Debenture Agreement, JNC made the following representation:

> Investment Intent. The Purchaser is acquiring the Securities for its own account for investment purposes only and not with a view to or for distribution or reselling such Securities or any part thereof or interest therein, *without prejudice, however, to the Purchaser's right, subject to the provisions of this Agreement and the Registration Rights Agreement, at all times to sell or otherwise dispose of all or any part of such Securities pursuant to an effective registration statement under the Securities Act and in compliance with applicable state securities laws or under an exemption from such registration.*

(Emphasis supplied.) The Debenture Agreement, executed April 30, 1998, contains the following merger clause:

> Entire Agreement; Amendments. *This Agreement,* together with the Exhibits and Schedules hereto, the Registration Rights Agreement, the Debentures, the Escrow Agreement, and the Warrants *contain the entire understanding of the parties* with respect to the subject matter hereof *and supercede all prior agreements and understandings, oral or written,* with respect to such matters, which the parties acknowledge have been merged into such documents, exhibits and schedules.

In light of these written contract terms, which reserve JNC's right to resell the securities, Global could not have been justified in relying on any prior oral representation not to sell. The purchase was an arms-length, negotiated transaction involving complicated convertible securities by sophisticated parties, and the parties reaffirmed the same limited investment representations when they were incorporated by reference into the later Exchange Agreement. At the time of their negotiation, the specter of short selling was a concern for both sides. The parties also include a merger clause in the Debenture Agreement, which states that it incorporates "all prior agreements and understandings, *oral* or written."As result, the terms of the agreement itself, as well as the relationship between the parties pleaded in the Amended Complaint, make any reliance on Chau's earlier oral representation unreasonable. The third cause of action against JNC and Chau must therefore also be dismissed.

IISection 9(e)

The Amended Complaint contains claims under Section 9(e) of the Exchange Act. In its brief, Global consents to the dismissal of those claims. As a result, the fourth, fifth, and sixth claims are dismissed against all defendants.

IIISections 13(d) and 16(a)-(c)

***12** The Amended Complaint alleges violations of Section 13(d) of Exchange Act and Section 16(a)-(c) against Thomson, Sovereign, Atlantis, and Bronia, as a group, and against JNC. Section 13(d) of the Exchange Act requires a person or persons acquiring beneficial ownership of more than five percent of the equity securities of any issuer to file a Schedule 13D within ten days.[6] 15 U.S.C. § 78m(d). Beneficial ownership includes those securities the person has a right to acquire within sixty days, including through the conversion of a security. 17 C.F.R. § 250.13d–3(d)(1). The purpose of Section 13(d) is to

> alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control....
> *GAF Corp. v. Milstein,* 453 F.2d 709, 717 (2d Cir.1971). Summarized briefly, Section 13(d) requires disclosure of the following information: (1) the background and identity of the acquiring persons, (2) the source and amount of funds used to make the purchases, (3) any purpose to make major changes to the issuer, (4) the number of shares beneficially owned, and (5) information as to agreements relating to the securities. 15 U.S.C. § 78m(d)(1)(A)-(E).*See also*17 C.F.R. §§ 240.13d–1 (filing of Schedules 13D and 13G). Although rejecting the existence of an implied right of action for damages under Section 13(d), courts in this circuit have recognized the existence of an implied right of action by an issuer for injunctive relief. *See,e.g.,GAF Corp.,* 453 F.2d at 720–21.

In its opposition to the motion to dismiss, Global withdraws its original claims under Section 16(a) and 16(c) of the Exchange Act, 15 U.S.C. § 78p(a), (c), and those aspects of the claims are therefore dismissed. Nonetheless, Global presses its claims under Section 16(b) of the Exchange Act. That section provides that a beneficial owner of more than ten percent of any class of equity security must turn over any profits earned, regardless of intent, from a purchase and sale of the securities occurring within six months.[7] The elements of a Section 16(b) claim are: "(1) a purchase and (2) a sale of securities (3) by ... a shareholder who owns more than ten percent of any one class of the issuer's securities (4) within a six-month period."*Gwozdzinsky v. Zell/Chillmark Fund L.P.,* 156 F.3d 305, 308 (2d Cir.1998).

The existence of a group, as dictated by Section 13(d)(3), affects the definition of a "person" and therefore the calculation of beneficial ownership under Section 13(d), and that is incorporated by reference under Section 16(b).*See*17 C.F.R. § 240.16a–1(a)(1); *Morales v. Freund,* 163 F.3d 763, 766 n. 4 (2d Cir.1999) (Section 16(b)); *GAF Corp.,* 453 F.2d at 715 (Section 13(d)). Section 13(d)(3) states that

> [w]hen two or more persons act as a partnership, limited partnership, syndicate, or other group for purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

***13** 15 U.S.C. § 78m(d)(3). Rule 13d–5 provides the following gloss on this section,

> [w]hen two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership for purposes of section 13(d) and (g) of the Act, as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons.

17 C.F.R. § 240.13d–5(b)(1).

As stated by the Second Circuit, "the touchstone of a group ... is that the members combined in furtherance of a common objective."*Wellman v. Dickinson,* 682 F.2d 355, 363 (2d Cir.1982). As a result, the group need not be committed to acquiring, holding, voting, or disposing of securities on a "specific set of terms" so long as "the members of the group have combined to further a common objective with regard to one of those activities."*Morales,* 163 F.3d at 767 n. 5.

A.Section 13(d) Claim Against the Thomson Defendants[8]

The Seventh Cause of action alleges that Thomson, Sovereign, Atlantis, and Bronia acted as a group owning more than five percent of plaintiff's registered equity securities with the common objective of driving down the price of Global common stock. Specifically, it alleges that by December 23, 1997, Thomson, Bronia, and Augustine[9] were the beneficial owners of 15% of Global common stock. By August 7, 1998, those defendants, along with Sovereign and Atlantis, are alleged to have become beneficial owners of 28% of Global common stock. As a result, the complaint alleges that the defendants have violated Section 13(d) by failing to provide the required disclosure on Schedule 13D. Furthermore, defendant Bronia is alleged to have filed a

Form 13G on December 15, 1998, misstating its beneficial ownership at 19.9%.

In their motion to dismiss, the Thomson Defendants make the following arguments with respect to Section 13(d): (1) there is no private right of action under Section 13(d) available to Global, (2) the allegations of group ownership are insufficient, and (3) the Thomson Defendants are prohibited from owning more that 9.99% of Global. [10] The first argument may be disposed of quickly, since, as discussed above, courts in this circuit have recognized a cause of action for injunctive relief, which is all that is sought by plaintiffs. [11]

The Thomson Defendants' additional argument that their activity does not come within the purview of Section 13(d) is also without merit. The text of Section 13(d) does not provide relief from disclosure based on purpose, with the exception that SEC rules allow certain persons acquiring shares for investment purposes to file a short-form Schedule 13G, rather than the more extensive Schedule 13D. *See*17 C.F.R. § 240.13d–1(b)(1). More importantly, however, the alleged activities by the Thomson Defendants implicate the core concerns of Section 13D, as stated by the Second Circuit in *GAF Corporation,* of accumulation of a large percentage of securities by a group. The cases relied upon by the Thomson Defendants that are supposedly to the contrary are distinguishable on their facts. *See, e.g.,Calvary Holdings, Inc. v. Chandler,* 948 F.2d 59, 64 (1st Cir.1991) (Section 13(d) does not apply to someone who holds stock in name only); *MTD Service Corp. v. Weldotron,* 93 Civ. 4980(MP), 1994 WL 455154, at * 7 (S.D.N.Y. Aug. 19, 1994) (directors' purchases of additional shares where market was otherwise informed through other SEC filings are peripheral to the core concerns of the Williams Act).

***14** The Court also rejects the Thomson Defendants' second argument, that the pleading requirements with respect to group formation have not been met. The Thomson Defendants argue that the allegations are conclusory, that there is no agreement alleged, and that the fact that Mark Valentine, a Thomson officer, served as the agent for the Thomson Defendants and Bronia is unremarkable since Valentine is just a broker, similar to a broker "holding stock in street name." The Court disagrees that the complaint is deficient. The relevant portion of the complaint reads as follows:

> Defendants Thomson, Sovereign, Atlantis, Bronia, Augustine acted together by express or tacit agreement as evidenced by the following facts, among others (a) Defendants Thomson, Sovereign, Atlantis and Bronia were introduced to Plaintiff by Defendant Valentine; (b) Defendant Valentine controlled and acted for Defendants Thomson, Sovereign, and Atlantis in purchasing the Convertible Preferred, as well as the convertible securities of many other companies; (c) Defendants Thomson, Sovereign, and Atlantis use the same mailing address; (d) Defendants Thomson, Sovereign, Atlantis and Bronia have used the same counsel in their dealings with [Global] and other companies; (e) Defendant Valentine executed the [Global] transaction documents for Defendants Thomson, Sovereign and Atlantis; and (f) various of these Defendants have engaged in similar unlawful and fraudulent conduct in connection with similar transactions with other public companies.

In addition, Global alleges that these defendants acted as a group with a common objective of improperly profiting from short sales in and driving down the price of Global common stock.

Based on these allegations, the Court finds that Global has sufficiently alleged the existence of a group under Section 13(d) to survive a motion to dismiss. The Thomson Defendants' comparison of the role of Valentine to that of an broker carrying out transactions on behalf of different clients, who may or may be aware of each other's existence, is entirely misplaced. Instead, as alleged, the transactions at issue were negotiated transactions. In that light, the alleged role of Valentine as purchaser and as executor of the agreements for each of the different entities acquires particular significance. At any rate, the facts allege a common objective and concerted conduct, consisting of a series of acquisitions, holding, and disposals, of the defendants in furtherance of that objective. Section 13(d) does not require more. *Cf.Morales,* 163 F.3d at 767 n. 5; *Wellman,* 682 F.2d at 363. Again, the cases cited by the Thomson Defendants are not to the contrary. *See, e.g.,Strauss v. American Holdings, Inc.,* 902 F.Supp. 475, 479–80 (S.D .N.Y.1995) (complaint allegation that same individual was responsible for transactions at each entity was sufficient to survive motion to dismiss); *Trans World Corp. v. Odyssey Partners,* 561 F.Supp. 1315, 1323 (S.D.N.Y.1983) (dismissing pleading that alleged generally only that defendants were a group and their "true purpose most definitely does involve an attempt to affect or influence the control of" the company). Dismissal of the seventh claim against the Thomson, Sovereign, and Atlantis would therefore be inappropriate.

B.Section 13(d) claim against Bronia

***15** The seventh claim against Bronia may also not be dismissed. The Court has already rejected the arguments made by the Thomson Defendants, and the additional arguments made by Bronia in its reply memorandum are not persuasive.

C.Section 13(d) claim against JNC

The eighth claim is brought solely against JNC and does not involve allegations with respect to the formation of a group. Instead, it alleges that on April 30, 1998, when JNC acquired the Convertible Debentures, it was the beneficial owner of 12% of Global common stock. On August 31, 1998, the date of the Exchange Agreement, Global alleges that JNC became the beneficial owner of 28% of Global common. As such, JNC is alleged to have failed to comply with the reporting requirements of Section 13(d). In response, JNC contends, in addition to other arguments, that because of provisions in both the Debenture Agreement and the Exchange Agreement that restrict it from acquiring more than 4.999% of Global common stock in a conversion, it is not the beneficial owner of 5% of Global common. The Court agrees.

Under Rule 13d–3(d)(1), a person is deemed to be a holder of the underlying security "if that person has *the right to acquire* beneficial ownership of such security, as defined in Rule 13d–3(a) ... within sixty days ... through the conversion of a security...." 17 C.F.R. § 240.13d–3(d)(1) (emphasis supplied). As a result, holders of freely convertible securities are generally deemed to be beneficial owners of the underlying common stock. Where conversion rights are limited, however, a holder of a convertible security may not be deemed the beneficial owner of the underlying common stock. For example, the SEC issued a no-action letter under Section 13(d) with respect to the acquisition by BancBoston of securities, the conversion of which would result in beneficial ownership of greater than 5%, where the charter of the acquired entity contained a provision that restricted the maximum percentage that BancBoston could hold of the underlying common to 4.9%. *BancBoston Capital Inc., SEC No–Action Letter,* 1987 WL 108100 (Aug. 10, 1987). Similarly, in *Levner v. Saud,* 903 F.Supp. 452, 461–62 (S.D.N.Y.1994), the Court granted summary judgment on a Section 16(b) claim, on the ground that although the preferred stock would give the investor beneficial ownership of greater than 10%, he was not a beneficial owner of the underlying common since the preferred was not immediately convertible. The Court found a sufficient restriction in defendant's having entered into a standstill agreement stating that the defendant would not convert his preferred until the occurrence of certain contingencies. The Second Circuit affirmed this holding in *Levner v. Prince Alwaleed,* 61 F.3d 8, 9 (2d Cir.1995).*See also* *Citadel Holding Corp. v. Roven,* 26 F.3d 960, 966–68 (9th Cir.1994) (under Section 16(b), based on provision in certificate of incorporation); *Transcon Lines v. A.G. Becker Inc.,* 470 F.Supp. 356, 370–71 (S.D.N.Y.1979) (under Section 13(d), based in part on contingencies in right of acquisition).

***16** Both parties agree that the Debenture Agreement contains the following provision:

> Purchase Ownership of Common Stock. The Purchaser *agrees not to convert Debentures ... to the extent such conversion or exercise would result in the Purchaser beneficially owning (as determined in accordance with Section 13(d) of the Exchange Act and the rules thereunder) in excess of 4.999% of the then issued and outstanding shares of Common Stock,* including shares issuable upon conversion of the Debentures and exercise of the Warrants held by such Purchaser after application of this Section.

(Emphasis supplied.) The end of the clause also permits JNC to circumvent the requirements of this provision on 75 days notice. The parties also agree that a substantially similar provision is contained in the Exchange Agreement. Based on this restrictive language, the Court concludes that this restriction is a sufficient restraint such that JNC is not the beneficial owner of more than 5~~f Global common stock. In the same agreements granting it the Convertible Debentures, and later the Convertible Preferred, JNC has undertaken not to convert in excess of the 4.99%. It may only do so on 75 days notice, greater than the 60 day requirement for "presently~~

~~convertible" in Rule 13d–3(1)(i). As such, it is not presently a beneficial owner in excess of 5% of Global common stock. Absent other allegations, the eighth claim alleging a violation of Section 13(d) against JNC must be dismissed.~~

D.Section 16(b) Claims

The Thomson Defendants, Bronia, and JNC argue that the Section 16(b) claim is inadequately plead since it does not allege a sale and purchase or any short swing profits. The Court agrees. Both claims allege that either the Thomson Defendants and Bronia or JNC is the beneficial owner of 10% or more of Global common stock. Although the complaint alleges "purchases" when the various convertible securities were acquired, there is no allegation of a sale at a higher price by the defendants within six months. As such, Global has failed to plead the elements of a cause of action, and the ninth and tenth claims must be dismissed in their entirety. [12]

IVSection 20(a)

The Thomson Defendants sought to dismiss the Eleventh Claim against Hicks and Valentine for controlling person liability under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), on the ground the claims are derivative of the other Exchange Act claims. Since at least the underlying Section 13(d) claim survives, dismissal of these claims would be inappropriate on the ground. Nonetheless, dismissal of the twelfth claim against Encore and Chau is appropriate since the underlying Exchange Act claims against JNC and Chau have been dismissed.

VCommon Law Fraud

A.Thomson Defendants, Bronia, and Skalko

The sixteenth and eighteenth claims allege that Thomson, Sovereign, Atlantis, Bronia, and Skalko each committed fraud when it made the Investment Representation, that Global relied on that misrepresentation, and that Global was injured as a result. Among other arguments, the defendants allege that a fraud claim may not be maintained because of the contracts between the parties.

***17** The elements of a fraud claim under New York law [13] are as follows: (1) defendant made a material misstatement, (2) the defendant intended to defraud the plaintiff thereby, (3) the plaintiff reasonably relied upon the representation, and (4) the plaintiff suffered damage as a result of such reliance. *Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc.,* 98 F.3d 13, 19 (2d Cir.1996). In order to avoid converting every breach of contract action into a fraud claim, however, a fraud claim may only proceed alongside a breach of contract claim where the plaintiff (1) demonstrates a legal duty separate from the duty to perform under the contract, (2) demonstrates a fraudulent misrepresentation collateral or extraneous to the contract, or (3) seeks special damages that are caused by the misrepresentation and unrecoverable as contract damages. *Id.* at 20.

The fraud claims allege that because the Investment Representation was not complied with, Global should not be required to perform under the agreements and is entitled to damages. The fraud claim is therefore essentially a breach of contract claim. Plaintiff does not argue that, as plead, the fraud claim comes within one of the three exceptions in *Recovery Credit.*The Court agrees with the Thomson Defendants' argument that the Investment Representation, as a term in the agreements between the parties, was not "collateral or extraneous" to those agreements such that a fraud claim may proceed. *Cf.Deerfield Comms. Corp. v. Chesebrough–Ponds, Inc.,* 510 N.Y.S.2d 88, 89 (N.Y.1986) (holding that oral statement prior to the contract and not included in the contract plead a fraud claim since "it is not a mere promissory statement as to what will be done in the future" and was a representation of present fact "collateral to, but which was the inducement for the contract" and was not duplicative of the breach of contract claim). As a result, the sixteenth claim is dismissed against Thomson, Sovereign, Atlantis, and Bronia, and the eighteenth claim is dismissed against Skalko.

B.JNC

JNC makes the same arguments with respect to the fraud claims as those made above with respect to the misrepresentation aspects of the Section 10(b) claim. Reasonable reliance is also a requirement of fraud under New York law. *SeeHarsco,* 91 F.3d at 342. As such, the fraud claim against JNC must also be dismissed on the basis that it was unreasonable for Global to rely on the alleged misrepresentation. The seventeenth claim is therefore dismissed against JNC.

VIAiding and Abetting Claims

Since the aiding and abetting claims are merely derivative of the underlying fraud claims, the nineteenth claim against Valentine and Hicks, and the twentieth claim against Encore and Chau must also be dismissed.

VIICivil Conspiracy Claim

Global alleges a civil conspiracy against the Thomson Defendants, Bronia, and the JNC Defendants. Nonetheless, New York law does not recognize an independent cause of action for civil conspiracy, and instead only recognizes a derivative cause of action based on another tort. *SeeDimon Inc. v. Folium, Inc.,*—F.Supp.2d—, 98 Civ. 6732(LAK), 1999 WL 280424, at *11 (S.D.N.Y. May 3, 1999); *Black Radio Network, Inc. v. Nynex Corporation,* 44 F.Supp .2d 565, 583 (S.D.N.Y.1999). The twenty-third claim does not purport to be a derivative claim and therefore must be dismissed.

VIIIBreach of Contract

***18** Under New York law, a breach of contract claim must allege (1) the existence of an agreement, (2) performance of the contract by the plaintiff, (3) breach of contract by the defendant, and (4) damages. *Harsco Corp. v. Segui,* 91 F.3d 337, 348 (2d Cir.1996). In addition, Rule 9(c), Fed.R.Civ.P., states that "[i]n pleading the performance or occurrence of conditions precedent, it is sufficient to aver generally that all conditions precedent have been performed or have occurred."*SeealsoICD Holdings S.A. v.. Frankel,* 976 F.Supp. 234, 243 (S.D.N.Y.1997).

The breach of contract claims allege that defendants' manipulative activities constitute a breach of the no-shorting and investment intent provisions. The defendants' main argument with respect to the breach of contract claim is that Global has failed to allege its own performance. Global responds by arguing that its performance is excused because of the breaches by the defendants. Nonetheless, even assuming for the moment that pleading excuse would meet the requirements of a breach of contract claim, the Amended Complaint contains no such allegation. As such, Global has failed to plead a breach of contract claim and the twenty-fifth claim against Thomson, Sovereign, Atlantis, Bronia, JNC, and Skalko must be dismissed.

IXImplied Covenant

Under New York law, there is a covenant of fair dealing and good faith implied in all contracts. *SeeCarvel Corp. v. Diversified Management Group, Inc.,* 930 F.2d 228, 230 (2d Cir.1991); *Van Valkenburgh, Nooger & Neville, Inc., v. Hayden Publishing Co.,* 330 N.Y.S.2d 329, 333 (N.Y.1972). Nonetheless, a breach of covenant claim has the same elements as a breach of contract claim. Since in this claim as well, Global has failed to plead its own performance under the contract, or assuming again the validity of pleading excuse, excuse from performance, the breach of covenant claim is defective and must be dismissed. As such, the twenty-sixth claim against Thomson, Sovereign, Atlantis, Bronia, JNC, and Skalko must also be dismissed.

XDeclaratory Relief under Section 29(b)

Global seeks a declaration under Section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), that because of the conduct set forth above, it has no further liability under the agreements with the defendants. Since all of the claims under the Exchange Act have been dismissed against JNC, Encore, and Chau, dismissal of this claim is warranted against them as well. Nonetheless, the claim survives against the remaining defendants.

XIReformation

Under New York law, reformation is appropriate where there is a mutual mistake as to the contract. *Healy v. Rich Products Corp.,* 981 F.2d 68, 73 (2d Cir.1992)."A 'mutual mistake' occurs when 'both ... parties to a bilateral transaction share the same erroneous belief and their acts do not in fact accomplish their mutual intent." ' *Id.* (quoting 21 N.Y.Jur.2d Contracts § 121 (1982)). Stated differently, "a contract can be reformed on the basis of mutual mistake if the writing does not accurately reflect the mutual intention of the parties...." *Investors Ins. Co. of America v. Dorinco Reins. Co.,* 917 F.2d 100, 105 (2d Cir.1990). Although "unilateral mistake alone" is insufficient to support a reformation claim, *Healy,* 981 F.2d at 73, reformation may be appropriate

> ***19** [i]n a case of fraud, [where] the parties have reached an agreement and, unknown to one party but known to other (who has misled the first), the subsequent writing does not properly express that agreement.

Chimart Assocs. v. Paul, 498 N.Y.S.2d 344, 347 (N.Y.1986).

The Amended Complaint alleges that the purpose of the contract was frustrated and that Global believed that the defendants would comply with the terms of the agreements. The complaint alleges that this belief was either shared by the defendants or that the defendants had an intent to profit unfairly. The Court is unable to square these allegations with the requirements of a reformation claim. Initially, the string of allegations is confusing and illogical, hardly providing fair notice of the elements of the claim. More importantly, the essence of reformation is that each party (or at least one of the two parties where there is fraud) mistakenly believed that the writing entered into by the parties reflected the understanding between them. *Chimart,* 498 N.Y.S.2d at 346–47. According to the complaint, however, the "mistaken" understanding that Global allegedly possessed was *in accordance* with the explicit terms of the agreement. There was therefore no mistake and no basis for reformation. The twenty-eighth claim must be dismissed.

XIIPersonal Jurisdiction

Defendant Mark Valentine also moves pursuant to Rule 12(b)(2), Fed.R.Civ.P., to dismiss all of the claims against him for lack of personal jurisdiction because he is protected by the fiduciary shield doctrine and because doing so would violate due process of law. Nonetheless, the fiduciary shield doctrine was a state law doctrine that was overruled by the New York Court of Appeals in *Kreutter v. McFadden Oil Corp.,* 527 N.Y.S.2d 195, 199 (N.Y.1988).*See alsoRetail Software Serv. Inc. v. Lashlee,* 854 F .2d 18, 22 (2d Cir.1988). The Court can see no basis to revive the doctrine under the securities laws. With respect to the due process argument, the analysis of the facts offered by Valentine is unpersuasive. As agent for several negotiated convertible preferred transactions and officer of Thomson, he cannot plausibly be analogized to a ministerial signer for Thomson and "broker/dealer" for Sovereign and Atlantis. Valentine executed many of the agreements as "agent." At least some of those agreements contain clauses consenting to personal jurisdiction in this Court by the "parties." Furthermore, at the very least, the Section 13(d) claim alleges that Valentine played a key role in the allegations that various defendants formed a group to engage in improper short selling to depress the price of Global, whose stock traded at the time on a United States exchange and whose stock is registered under the Exchange Act. Based on the facts alleged in the complaint and the unpersuasive factual presentation made by Valentine, the Court can see no basis under either a minimum contacts or fairness analysis for dismissal of the claims against Valentine. *SeeKernan v. Kurz–Hastings, Inc.,* 175 F.3d 236, 242–245 (2d Cir.1999).

XIIILeave to Amend

***20** Global seeks leave to amend so that it may: (1) add certain additional facts, (2) amend the pleading of loss causation for the Section 10(b) claims, and (3) amend the pleading of the breach of contract claims to plead its own performance. Global's application is granted, limited to the listed items, and it shall file an amended pleading within two weeks of the date of this Opinion and Order.

CONCLUSION

For the reasons stated, defendants' motions are denied in part and granted in part. Defendants' motions are granted with respect to the following claims in the Amended Complaint: the first claim against Thomson, Sovereign, Atlantis, Bronia, Valentine, and Hicks; the second claim against Skalko; the third claim against JNC and Chau; the fourth, fifth, and sixth claims against all defendants; the eighth claim against JNC; the ninth claim against Thomson, Sovereign, Atlantis, and Bronia; the tenth claim against JNC; the twelfth claim against Encore and Chau; the sixteenth claim against Thomson, Sovereign, Atlantis, and Bronia; the seventeenth claim against JNC; the eighteenth claim against Skalko; the nineteenth claim against Valentine and Hicks; the twentieth claim against Encore and Chau; the twenty-third claim against all defendants; the twenty-fifth and twenty-sixth claims against the Thomson, Sovereign, Atlantis, Bronia, JNC, and Skalko; the twenty-seventh claim against the JNC, Encore, and Chau; and the twenty eighth claim against all defendants. The remaining portions of the motions are denied. Global's application to amend the complaint is granted, limited to the requested amendments.

SO ORDERED:

Parallel Citations

Fed. Sec. L. Rep. P 90,534

Footnotes

1 To date, Global has voluntarily dismissed all claims against the following defendants named in the Amended Complaint: Augustine Fund L.P., James W. Spratt, Susan Spratt, the Spratt Family Trust, and Frederick A. Lenz. The following defendants have not yet appeared in this action: Suaro Limited, Martin Jill, Louise Nilldotter, Philip Gurian, and SMS Capital Services.

2 To simplify the factual presentation, the Court has only included factual allegations with respect to the defendants involved in the current motions to dismiss, except where otherwise necessary.

3 Although the Complaint does not so state, in its papers, the JNC Defendants state that this written representation comes from Paragraph 2.2(b) of the Debenture Agreement. Global does not contest that this is the source of the language. Although not stated by any party, Paragraph 5 of the later Exchange Agreement incorporates this representation by reference. On a motion to dismiss, the Court may consider documents that are attached to the complaint as exhibits or incorporated by reference. *SeeNewman & Schwartz v. Asplundh Tree Expert Co.,* 102 F.3d 660, 662 (2d Cir.1996).

4 The Thomson Defendants also argue that since they did not sell their preferred shares, they did not violate the Investment Representation that they are “acquiring the shares of Preferred Stock subscribed solely for investment purposes for the Subscriber's own account ... and not with a view to a distribution of all or any part thereof.”This argument is specious, however, since it ignores the remaining portion of the Investment Representation, which includes language that: “The Subscriber has no intention of arranging or engaging in, whether directly or indirectly alone or with others, a plan or scheme to promote or facilitate selling short the shares of the Company's Common Stock.”

5 Global also alleges that it relied on the investment representation made by JNC in the Debenture Agreement. Nonetheless, unlike the Investment Representation made by other defendants, JNC's investment representation contains no restriction that would implicate the practices allegedly engaged in by JNC. Furthermore, the full text of the provision, quoted below, makes clear that its sole purpose was to require compliance with the securities laws and not to restrict JNC's ability to trade in Global's underlying common stock.

6 Section 13(d)(1) reads in pertinent part as follows:

> Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 781 of this title, ... is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, ... send to each exchange where the security is traded, and file[ ] with the Commission, a statement containing such of the following information....

15 U.S.C. § 78m(d)(1).

7 Section 16(b) reads in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner ... any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer ... within any period of less than six months ... shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner ... in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer....

15 U.S.C. § 78p(b). “Such beneficial owner” refers to “[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security” in Section 16(a).15 U.S.C. § 78p(a).

8 Both Global and the Thomson Defendants take note of the Schedule 13D filed by Sovereign on March 25, 1999, on behalf of Sovereign, Atlantis, and Thomson. Each makes factual arguments that the existence and content of the Schedule 13D support their position. The Court need not consider these conflicting factual arguments at this time.

9 Claims against Augustine have since been dismissed.

10 With respect to this last argument, a restriction of 9.99% would not preclude a Section 13(d) violation, since the threshold for the statute is 5%. The Court would note, however, that the effectiveness of such an agreement is in any event limited where the complaint alleges formation of a group and not just action by the single defendant that executed the agreement. Moreover, the provision of the agreement referenced by the Thomson Defendants (“¶ 6(h)”) supposedly containing this restriction, does not exist at that section in the Series 6, 10, and 11 Agreements provided to the Court in support of the Thomson Defendants' motion to dismiss.

11 The parties spend some time discussing the availability of particular relief. The Court need not reach that issue on a motion to dismiss.

12 In the event that this were not the result, the Court's conclusion with respect to the eighth claim against JNC under Section 13(d) provides an alternative basis for the dismissal of the tenth claim against JNC.

13 The parties have briefed the common law claims under New York law and thereby have consented to its application as the law of the forum state. *SeeAmerican Fuel Corp. v. Utah Energy Development Co.,* 122 F.3d 130, 134 (2d Cir.1997). In addition, at least some of the agreements contain choice of law clauses stating that they are governed by New York law. New York generally respects the choice of law of the parties. *SeeWoodling v. Garrett Corp .,* 813 F.2d 543, 551 (2d Cir.1987).

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