

United States District Court  
For the Northern District of California

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

No. C 08-01510 WHA

IN RE:

CHARLES SCHWAB CORPORATION  
SECURITIES LITIGATION.

This Document Relates  
To All Cases.

**ORDER REGARDING  
DEFENDANTS’ MOTIONS  
FOR SUMMARY JUDGMENT  
REGARDING SECTION 12  
AND SECTION 17200 CLAIMS**

**INTRODUCTION**

In this securities class action, plaintiffs allege that defendants violated Section 12 of the Securities Act of 1933 and California Business & Professions Code Section 17200. Defendants Mariann Byerwalter, Donald F. Dorward, William A. Hasler, Robert G. Holmes, Gerald B. Smith, Donald R. Stephens, and Michael W. Wilsey, who were employees of Charles Schwab Corporation and independent trustees of Schwab Investments (collectively, “independent trustees”), move for summary judgment on the Section 12 and Section 17200 claims. Defendant Kimon Daifotis separately moves for summary judgment as well. Material issues of fact exists with regard to whether the independent trustees and defendant Daifotis solicited investors. For the reasons that follow, the independent trustees’ motion is **DENIED IN PART** and **GRANTED IN PART**, and defendant Daifotis’ motion is **DENIED**.

**STATEMENT**

This action originated as multiple independent class actions filed by investors in Schwab’s YieldPlus Fund, a short-term fixed-income mutual fund. These actions were

1 consolidated into the present class action with six lead plaintiffs: Kevin O'Donnell, James  
2 Coffin, John Hill, David and Gretchen Mikelonis, and Robert Dickson. Gretchen Mikelonis has  
3 since withdrawn as a lead plaintiff. Plaintiffs bring this action against several Schwab corporate  
4 entities, officers and employees of those entities, and trustees of Schwab Investments who signed  
5 the registration statements at issue.

6 Defendant Charles Schwab Corporation was the parent corporation of the Charles  
7 Schwab financial services complex. Charles Schwab & Co., Inc. ("CS&Co.") was the parent  
8 company of Schwab Investments and was the principal underwriter and distributor for shares of  
9 the fund. Charles Schwab Investment Management, Inc. ("CSIM") was the asset management  
10 arm of the Charles Schwab Corporation; it oversaw the asset management and administration of  
11 the fund. Schwab Investments, a business trust organized under the laws of Massachusetts, was  
12 the registrant for the fund, the issuer of fund shares and performed trust services for the fund.  
13 Defendant Kimon Daifotis was the head of fixed income portfolio management at Schwab  
14 Management. The independent trustees signed the registration statements at issue.

15 Schwab YieldPlus Fund was an open-ended mutual fund organized as a Massachusetts  
16 business trust registered under the Investment Company Act. It offered two classes of shares:  
17 Investor Shares and Select Shares. The latter had a higher minimum investment requirement,  
18 but lower fees compared to the former.

19 Plaintiffs allege that defendants violated Section 12(a)(2) of the Securities Act of 1933  
20 by misleading investors when they described the YieldPlus Fund as an "ultrashort" bond fund  
21 that was a safe alternative to cash and which had "minimal" risk of a fluctuating share price.  
22 Plaintiffs allege that the fund was not an ultrashort bond fund, was not "stable," and was not  
23 "safe," because it was comprised of assets that were not truly short-term in nature and were  
24 otherwise riskier than represented. Plaintiffs also allege that the true risks presented by the  
25 fund's assets were eventually revealed and, as a result, investors suffered losses.

26 Additionally, plaintiffs allege a state law claim under Section 17200 of California's  
27 Business and Professions Code against the independent trustees. Plaintiffs allege that the  
28 independent trustees violated the YieldPlus Fund's policy not to concentrate investments in a

1 particular industry or group of industries when they invested over 45% of the YieldPlus Fund’s  
2 assets in mortgage-backed securities without first obtaining a majority vote of shareholders, in  
3 violation of Section 13(a) of the Investment Company Act of 1940. Plaintiffs allege that this  
4 investment also violated Section 17200.

5 A previous order (Dkt. No. 233) certified three classes of plaintiffs. Of the two separate  
6 federal classes, one is a Section 12 class. The Section 12 class includes “all persons or entities  
7 who acquired shares of the fund traceable to a false and misleading prospectus for the fund who  
8 were damaged thereby.” The class period for the Section 12 class is May 31, 2006, through  
9 March 17, 2008.

10 The independent trustees seek summary judgment on plaintiffs’ second and fourth claim  
11 as against them. The second claim asserts that the independent trustees violated Section 12 of  
12 the Securities Act of 1933. The fourth claim asserts that the independent trustees violated  
13 Section 17200 of the California Business and Professions Code. Defendant Daifotis seeks  
14 summary judgment on plaintiffs’ second claim, which asserts that he violated Section 12 of the  
15 Securities Act of 1933.

## 16 ANALYSIS

### 17 1. LEGAL STANDARD.

18 Summary judgment is granted when “the pleadings, depositions, answers to  
19 interrogatories, and admissions on file, together with the affidavits, if any, show that there is  
20 no genuine issue as to any material fact and that the moving party is entitled to a judgment as a  
21 matter of law.” FRCP 56(c). A district court must determine, viewing the evidence in the light  
22 most favorable to the nonmoving party, whether there is any genuine issue of material fact.  
23 *Giles v. General Motors Acceptance Corp.*, 494 F.3d 865, 873 (9th Cir. 2007). A genuine issue  
24 of fact is one that could reasonably be resolved, based on the factual record, in favor of either  
25 party. A dispute is “material” only if it could affect the outcome of the suit under the governing  
26 law. Summary judgment is not granted if the dispute about a material fact is “genuine” — that  
27 is, if the evidence is such that a reasonable trier of fact could return a verdict for the nonmoving  
28 party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248–49 (1986).

1           The moving party “has both the initial burden of production and the ultimate burden of  
2 persuasion on a motion for summary judgment.” *Nissan Fire & Marine Ins. Co., Ltd. v. Fritz*  
3 *Cos., Inc.*, 210 F.3d 1099, 1102 (9th Cir. 2000). When the moving party meets its initial burden,  
4 the burden then shifts to the party opposing judgment to “go beyond the pleadings and by [its]  
5 own affidavits, or by the depositions, answers to interrogatories, and admissions on file,  
6 designate specific facts showing that there is a genuine issue for trial.” *Celotex Corp. v. Catrett*,  
7 477 U.S. 317, 324 (1986).

8           **2. INDEPENDENT TRUSTEES’ MOTION FOR SUMMARY JUDGMENT.**

9           As trustees of the fund, the independent trustees were designated specific powers in order  
10 to manage the fund pursuant to a trust agreement (Berman Decl. Exh. 16). These powers  
11 allowed the independent trustees to hire CSIM (*ibid.*) and CS&Co. (Berman Decl. Exh. 5).  
12 Despite hiring CSIM and CS&Co., the independent trustees retained the ultimate decision-  
13 making authority over the fund (Berman Decl. Exhs. 16, 5).

14           The independent trustees maintained direct oversight of the fund’s management through  
15 various committees. The committees included Investment Oversight, Marketing, Distribution  
16 and Shareholder Servicing, Audit and Compliance, and Governance Committee. The  
17 committees were responsible for proposing recommendations to the independent trustees, who  
18 would then discuss and vote on the recommendations at board meetings (Berman Decl. Exh. 19).  
19 The independent trustees exercised their decision-making authority on issues that contributed  
20 to the fund’s decline. For example, the independent trustees discussed and approved the  
21 recommendation to eliminate the 25 percent cap on non-agency collateralized mortgage  
22 obligations (Berman Decl. Exhs. 22, 23). The independent trustees knew that this change would  
23 require the Statements of Additional Information to be revised (Berman Decl. Exh. 24) and that  
24 it would alter the composition of the fund’s portfolio (Berman Decl. Exh. 25).

25           The independent trustees also participated in the marketing efforts of the fund by serving  
26 on the Marketing, Distribution, and Shareholder Serving Committee (Berman Decl. Exh. 6).  
27 As committee members, the independent trustees reviewed samples of the fund’s marketing and  
28 provided input into the advertising (Berman Decl. Exh. 8). For example, at a board meeting in

1 August 2006, the independent trustees reviewed and approved a response to a letter sent by the  
2 SEC, which criticized the fund’s advertisements because they did not contain balanced  
3 disclosures (Berman Decl. Exh. 14).

4 The record further reveals that the independent trustees reviewed samples of the fund’s  
5 marketing. On February 7, 2008, Jennifer Hafner, President of CSIM’s Product Development  
6 Group, wrote, “For your review I have attached the YieldPlus marketing and distribution  
7 presentation. This topic will be discussed during the Marketing and Distribution sub-committee  
8 meeting” (Berman Decl. Exh. 9). This email may have been a response to defendant Smith’s  
9 request during a board meeting on January 22, 2008 “that at the next quarterly Board Meeting  
10 the Trustees be provided with an update of the [YieldPlus] Fund’s strategic positioning from a  
11 portfolio management standpoint and a marketing and distribution standpoint” (Berman Decl.  
12 Exh. 10). Employees of CSIM also testified that the independent trustees reviewed story boards  
13 of advertisements from different funds and that the independent trustees provided input into the  
14 advertising (Berman Decl. Exhs. 11, 12). The independent trustees, however, dispute that they  
15 participated in the marketing efforts of the fund. The independent trustees declare that they  
16 “did not draft or approve any YieldPlus fund advertisements” and that they “did not direct the  
17 solicitation efforts of any person or entity involved in selling YieldPlus fund shares”  
18 (Taylor Decl. Exh. 1).

19 **A. Second Claim: Violation of the Securities Act of 1933.**

20 The independent trustees assert that plaintiffs’ second claim fails as against them because  
21 plaintiffs cannot show that the independent trustees were “sellers” under Section 12 of the Act.  
22 Section 12(a)(2) governs civil liabilities arising in connection with prospectuses and other  
23 communications to shareholders. The statute states, in relevant part:

24 (a) In general

25 Any person who—

26 \* \* \*

27 (2) offers or sells a security . . . by means of a prospectus or  
28 oral communication, which includes an untrue statement of  
a material fact or omits to state a material fact necessary in  
order to make the statements, in the light of the

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable . . . to the person purchasing such security from him . . .

15 U.S.C. 77l(a)(2). Such a claim may be asserted against the “seller” of a security. *Ibid.* The Supreme Court in *Pinter v. Dahl*, 486 U.S. 622, 647 (1988), interpreted “seller” to mean the “owner who passed title” or any “person who successfully solicits the purchase motivated at least in part by a desire to serve his own financial interest or those of the security owner.” As the Ninth Circuit explained, “plaintiff must allege [and, eventually, prove] that the defendant did more than simply urge another to purchase a security; rather, the plaintiff must show that the defendant solicited the purchase of the securities for their own financial gain.” *In re Daou Systems, Inc.*, 411 F.3d 1006, 1029 (9th Cir. 2005). (The Ninth Circuit has also clarified that *Pinter’s* analysis of claims under Section 12(a)(1) governs claims under Section 12(a)(2) as well. *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 535–36 (9th Cir. 1989).) The Ninth Circuit has not addressed whether the aggregate effect of signing registration statements, participating in marketing efforts, and retaining ultimate authority over and knowledge about a fund constitutes solicitation of a fund’s shares under Section 12(a)(2) of the Act. The Ninth Circuit has also not addressed whether any of the above acts, standing alone, amount to solicitation under Section 12(a)(2).

The independent trustees assert that they should be granted summary judgment because plaintiffs cannot pass the first of two tests under *Pinter*. More specifically, the independent trustees assert that plaintiffs cannot establish that they passed title to fund shares. Plaintiffs agree that the independent trustees did not pass title to class members, as the undisputed evidence shows that the corporate entity Schwab Investments owned the fund and passed title to class members (Berman Decl. Exh. 5). The question, therefore, rests on whether the independent trustees solicited the purchase of the securities for their own financial gain.

The independent trustees assert that they should be granted summary judgment because plaintiffs cannot prove this. More specifically, the independent trustees assert that the evidence

1 is undisputed that they did not solicit the purchase of the fund’s shares. Their argument,  
2 however, is premised on a selective reading of the evidence in the record. Counsel for the  
3 independent trustees asserts that (Br. 3–4) (internal citations omitted):

4 Plaintiffs dutifully alleged, in their complaint, that the independent  
5 trustees “were ‘participants’ in the distribution of the fund’s  
6 shares,” “‘offered and sold’” shares, and “‘actively solicited the  
7 sale of the fund’s shares.’” No evidence supports these  
8 allegations. None of the independent trustees played any role in  
9 soliciting investors in the YieldPlus fund. They did not draft or  
10 approve the fund’s advertisements. They did not participate in any  
11 solicitation efforts of the YieldPlus fund’s underwriter, Charles  
12 Schwab & Co., Inc. And, with one isolated exception, none of the  
13 trustees spoke with, or otherwise communicated with, any  
14 individual investors about the YieldPlus fund.

15 Counsel’s assertions are true to the extent that they are aligned with the sworn declarations of  
16 each of the independent trustees. All of the independent trustees, except for one, prepared sworn  
17 declarations that stated, in relevant part, as follows (Taylor Decl. Exh. 1):

18 I have never personally solicited any investor to purchase  
19 YieldPlus fund shares. To the best of my recollection, I have  
20 never spoken, or otherwise communicated with, any investor about  
21 the possibility of purchasing YieldPlus fund shares. I did not draft  
22 or approve any YieldPlus fund advertisements. I did not direct the  
23 solicitation efforts of any person or entity involved in selling  
24 YieldPlus fund shares.

25 Defendant Holmes prepared a similar, but slightly different sworn declaration that stated, in  
26 relevant part, as follows (Taylor Decl. Exh. 1) (emphasis added):

27 I have never personally solicited any investor to purchase YieldPlus  
28 fund shares. To the best of my recollection, *I have only spoken with*  
*a single investor about the YieldPlus fund.* To the best of my  
recollection, other than this isolated incident, I have never spoken,  
or otherwise communicated with, an investor about the possibility  
of purchasing YieldPlus fund shares. I did not draft or approve any  
YieldPlus fund advertisements. I did not direct the solicitation  
efforts of any person or entity involved in selling YieldPlus fund  
shares.

29 The assertions of counsel and the sworn declarations of the independent trustees conflict  
30 with other evidence in the record. The record shows that the independent trustees maintained  
31 direct oversight of the fund’s management through various committees. The committees were  
32 responsible for proposing recommendations to the independent trustees, who would then discuss  
33 and vote on the recommendations at board meetings (Berman Decl. Exh. 19).

1           The record shows that the independent trustees participated in the marketing efforts of  
2 the fund by serving on the Marketing, Distribution, and Shareholder Serving Committee  
3 (Berman Decl. Exh. 6). As committee members, they reviewed samples of the fund’s marketing  
4 and provided input (Berman Decl. Exh. 8). Plaintiffs point to the board meeting in August 2006,  
5 at which the independent trustees reviewed a letter sent by the SEC that criticized the fund’s  
6 advertisements because they did not contain balanced disclosures (Berman Decl. Exh. 14).  
7 The letter directed that “[t]he Funds and CSCO should review the YieldPlus Fund’s sales  
8 materials to ensure that they are accurate and contain sufficient, balanced disclosure to avoid  
9 being false or misleading” (Berman Decl. Exh. 13). The independent trustees reviewed the letter  
10 and approved a response to it during the board meeting (Berman Decl. Exh. 14).

11           Plaintiffs point to other evidence in the record that reveals that the independent trustees  
12 reviewed samples of the fund’s marketing. For example, plaintiffs reference the letter written by  
13 Jennifer Hafner regarding the independent trustees’ review of the YieldPlus marketing and  
14 distribution presentation (Berman Decl. Exh. 9). Furthermore, plaintiffs note that employees of  
15 CSIM testified that the independent trustees reviewed story boards of advertisements from  
16 different funds and that the independent trustees provided input into the advertising (Berman  
17 Decl. Exhs. 11, 12).

18           These issues alone are sufficient to preclude summary judgment. The record does not  
19 unequivocally support the independent trustees’ position that they did not solicit the purchase  
20 of the fund’s shares. As described at length above, the independent trustees’ sworn declarations  
21 conflict with the other evidence presented by plaintiffs. Plaintiffs have demonstrated that the  
22 record is not so one-sided. After weighing the evidence, a jury could find that the cumulation of  
23 the independent trustees’ actions amounted to a solicitation.

24           This order recognizes that there is a separate issue as to whether the independent trustees  
25 acted “for their own personal gain” as required under *Pinter*. The independent trustees’ motion  
26 for summary judgment, however, relied on the seller requirement of Section 12 as being  
27 dispositive and did not address the financial gain requirement. This order, therefore, does not  
28 address the financial gain requirement.



1 For the reasons explained above, the independent trustees’ motion for summary judgment  
2 as to plaintiffs’ second claim is **DENIED**.

3 **B. Fourth Claim: Violation of the California**  
4 **Business and Professions Code.**

5 The independent trustees’ argue that plaintiffs’ fourth claim, violation of the California  
6 Business and Professions Code Section 17200, fails as against them because plaintiffs do not  
7 have a basis for seeking restitution from the independent trustees. Plaintiffs do not oppose the  
8 independent trustees’ motion as to the fourth claim. “An order for restitution is one ‘compelling  
9 a UCL defendant to return money obtained through an unfair business practice to those persons  
10 in interest from whom the property was taken, that is, to persons who had an ownership interest  
11 in the property or those claiming through that person.’” *Korea Supply Co. v. Lockheed Martin*  
12 *Corp.*, 29 Cal. 4th 1134, 1149 (2003). The compensation paid to the independent trustees was  
13 paid by their employer and not the fund’s investors. Furthermore, the undisputed evidence  
14 shows that the independent trustees did not receive any money from any investor. Accordingly,  
15 the independent trustees’ motion for summary judgment as to plaintiffs’ fourth claim is  
16 **GRANTED**.

17 **3. DEFENDANT DAIFOTAS’ MOTION FOR SUMMARY JUDGMENT.**

18 The only claim remaining in this matter against defendant Daifotis is brought under  
19 Section 12(a)(2). Like the independent trustees, defendant Daifotis argues that he was not a  
20 statutory “seller” under Section 12(a)(2) because he did not directly solicit investors’ purchases  
21 of YieldPlus shares.

22 Defendant Daifotis was an employee of CSIM, the entity hired by Schwab Investments  
23 (which was the title owner of the YieldPlus shares sold to investors) as the investment advisor  
24 and administrator of the YieldPlus Fund (Daifotis Dep. at 13). His responsibilities included  
25 oversight of the Fixed Income Portfolio Management group, which included the Taxable Bond  
26 Portfolio Management Team that oversaw the fund’s investments (*id.* at 14). He was also a  
27 representative of Schwab Investments.

28 Plaintiffs call defendant Daifotis the face and the voice of the fund. His image appeared  
in advertisements promoting the fund, including fact sheets constituting omitting prospectuses

1 (Berman Decl. Exh. 1). His promotional activities on behalf of the fund included  
2 communicating with Schwab’s Financial Consultants and Registered Investment Advisors to  
3 answer their questions about the fund, speaking directly with certain clients about the fund,  
4 conducting webcasts, going on branch visits, and participating in industry conferences (Berman  
5 Decl. Exhs. 15–18). Plaintiffs cite to more than 40 appearances by defendant Daifotis before  
6 investors and financial media where he promoted Schwab and its funds, including the YieldPlus  
7 Fund (Berman Decl. Exhs. 19–34). Plaintiffs point to his 2006 employment review which noted  
8 in part that he was “a tireless marketer of the funds” (Berman Decl. Exh. 35). They also point to  
9 his 2005 and 2007 self assessments, where he wrote of his promotional efforts of the fund  
10 (Berman Decl. Exhs. 14, 36). They cite to the deposition of Keith Maddock, a senior product  
11 manager for CSIM who testified that defendant Daifotis reviewed new fund marketing pieces  
12 (Berman Decl. Exh. 37). Finally, they note that he signed a letter sent directly to fund investors  
13 entitled “a message from the Schwab YieldPlus Bond Fund Manager, Kim Daifotis” (Berman  
14 Decl. Exh. 39). In that letter, he discussed the factors that investors should consider in deciding  
15 whether to hold the fund.

16 Defendant Daifotis argues that these promotional efforts and his role as a subject-matter  
17 expert and spokesperson for Schwab’s fixed income funds (including the YieldPlus Fund) does  
18 not make him a statutory seller. His deposition reflects his position. In response to the question,  
19 “Is it your testimony that you did not at all at the time you were chief investment officer make  
20 any efforts to get others to invest in the fund?,” defendant Daifotis replied, “That is correct”  
21 (Daifotis Dep. at 27). However, his actions establish at the least a question of fact which should  
22 be left to the jury regarding whether or not he is a seller.

23 Similar to the independent trustees’ motion for summary judgment, defendant Daifotis’  
24 motion only addressed the seller requirement of Section 12. This order, therefore, does not  
25 address the financial gain requirement of Section 12.

26 For the reasons explained above, defendant Daifotis’ motion for summary judgment is  
27 **DENIED.**

28

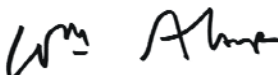
1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**CONCLUSION**

For the foregoing reasons, the independent trustees' motion for summary judgment is **DENIED IN PART and GRANTED IN PART**. Defendant Daifotis' motion for summary judgment is **DENIED**.

**IT IS SO ORDERED.**

Dated: April 8, 2010.

  
\_\_\_\_\_  
WILLIAM ALSUP  
UNITED STATES DISTRICT JUDGE