UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	
v.	:	**Civil Action No. 09-1423 (GK)**
STEVEN R. CHAMBERLAIN, ELAINE M. BROWN, and GARY A. PRINCE,	:	
Defendants.	:	

CONSOLIDATED MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO MOTIONS TO DISMISS FILED BY DEFENDANTS CHAMBERLAIN, BROWN AND PRINCE

Arthur S. Lowry
Jose M. Rodriguez
U.S. Securities and Exchange Commission
100 F St. NE
Washington, DC 20549
(202) 551-4918 (Lowry phone)
(202) 772-9245 (Lowry fax)

Counsel for Plaintiff
U.S. Securities and Exchange Commission

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INTRODUCTION

Plaintiff, U.S. Securities and Exchange Commission ("Commission"), filed its Complaint alleging that the defendants, Steven R. Chamberlain, the former Chief Executive Officer ("CEO") of Integral Systems Inc. ("ISI"), Elaine M. Brown, ISI's former Chief Financial Officer ("CFO"), and Gary A. Prince ("Prince"), ISI's CFO prior to Brown, engaged in a scheme to fraudulently conceal from the investing public the fact that Prince was involved in ISI's management as a *de facto* executive officer. The concealment scheme is alleged to have run from approximately December 1998 when Prince was rehired after serving a criminal sentence for securities fraud, to August 8, 2006, when ISI filed a Form 8-K with the Commission that finally informed the public of Prince's identity and role at ISI as an "Executive Vice President and Managing Director of Operations," and of Prince's history of criminal and civil securities law violations.

Defendants Chamberlain and Brown have moved to dismiss all claims against them,[1] and defendant Prince has moved to dismiss the antifraud charges against him. As shown below, these motions are meritless. Defendants Chamberlain and Brown also argue that the five year limitation period in 28 U.S.C. § 2462 for civil penalties bars certain relief or limits the evidence this court can consider to conduct occurring within the last five years. This argument is also meritless. The defendants' motions to dismiss should be denied.

[1] The Complaint's First and Second Claims allege that all defendants violated the antifraud provisions of the securities laws by failing to disclose information required by the federal securities laws concerning Prince in the company's periodic reports and proxy statements. The Complaint's Third and Fifth Claims respectively allege that the defendants violated, or aided and abetted violations of, the reporting and proxy statement provisions of the federal securities laws. The Fourth Claim alleges that defendants Chamberlain and Brown falsely certified ISI's annual reports for the years 2002 through 2005 which failed to disclose Prince. The Sixth and Seventh Claims respectively allege that Prince violated Exchange Act § 16(a) and Rule 16a-3 by failing to report his holdings and transactions in ISI securities, and that he violated a Commission Order precluding him from practicing as an accountant before the Commission.

ARGUMENT

I.
The Complaint Clearly Sets Forth Claims on Which Relief Can Be Granted

A. The Defendants Bear a Heavy Burden

In assessing the defendants' motions to dismiss, "a court 'construe[s] the complaint liberally in the plaintiff's favor . . . accepting[ing] as true all of the factual allegations contained in the complaint . . . with the benefit of all reasonable inferences derived from the facts alleged." *Aktieselskabet AF 21 Nov. 2001 v. Fame Jeans, Inc.,* 525 F.3d 8, 15 (D.C. Cir. 2008) (internal citations omitted).

As the D.C. Circuit held in *Fame Jeans*, a complaint suffices if it serves the philosophy embodied in Federal Rule of Civil Procedure 8 of giving notice "of the general nature of the case and the circumstances or events upon which it is based." *Fame Jeans*, 525 F.3d at 17. Giving notice, however, does not require the plaintiff to detail all the facts on which the claims are based, or indeed to plead any specific quantity of facts. The Supreme Court underscored this principle in *Erickson v. Pardus*, 551 U.S. 89 (2007) (per curiam), stating:

> Specific facts are not necessary [to state a claim]; the statement need only "give the defendant fair notice of what the … claim is and the grounds upon which it rests" … In addition, when ruling on a defendant's motion to dismiss, a judge must accept as true all of the factual allegations contained in the complaint.

Erikson, 551 U.S. at 93-94 (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007)) (internal citations omitted); s*ee also Rooney Pace, Inc. v. Reid*, 605 F. Supp. 158, 163 (S.D.N.Y. 1985) ("A complainant is not required to plead evidence").

In other words, a complaint is sufficient if it identifies "the circumstances, occurrences and events giving rise to the claim" or "informs the opponent of the affair or transaction to be litigated" thereby giving notice to the defendant of what it must contest. *Fame Jeans*, 525 F.3d

at 16. This is so, partly because at the pleading stage, the issue is not the probable success of the claim, but is whether the plaintiff is entitled to move forward and offer evidence to support the claims alleged. This liberal pleading standard requires a court to deny a motion to dismiss even if the Court has doubts about its ultimate merits, "for a complaint 'may proceed even if it appears 'that recovery is very remote and unlikely.'" *Fame Jeans*, 525 F.3d at 17 (*quoting Twombly*, 550 U.S. at 555); *cf. Scheuer v. Rhodes*, 416 U.S. 232 (1974) (motions to dismiss for failure to state a claim should be denied even if the possibility of ultimate recovery is remote). Under these settled standards, the Complaint easily withstands the defendants' motions to dismiss.

B. <u>The Complaint, Fairly Read, Gives Sufficient Notice of the Alleged Scheme</u>

Fairly read, the Commission's complaint gives notice that the defendants are alleged to have violated the federal securities laws by engaging in a scheme to conceal from the public the true extent of defendant Prince's involvement in ISI following his conviction for securities fraud, this Court's permanent injunction against him for future violations of Section 10(b) and Rule 10b-5, and following the Commission's Order denying him the privilege of practicing as an accountant before the Commission.[2]

The defendants accomplished this concealment scheme by, among other means, filing ISI annual reports and proxy statements with the Commission that omitted numerous required disclosures concerning Prince - including the most basic, his identity and role - disclosures that the federal securities laws require because Prince was a *de facto* ISI executive officer, a *de facto*

[2] Prince worked part-time at ISI starting in 1982, becoming its Vice President and CFO in 1992. During this time, Prince committed criminal financial fraud while serving as a financial officer of Financial News Network, another public company. As a result this conduct, this Court permanently enjoined Prince from committing further securities laws violations in 1994, and Prince entered a plea of guilty to criminal charges of conspiracy to commit securities and bank fraud and to making false statements to the Commission in 1995. In 1997, Prince was denied the privilege of appearing or practicing before the Commission as an accountant. Complaint, ¶¶ 2, 16, 18-20.

officer, a significant employee, and/or one of the most highly compensated individuals at ISI.[3] Defendant Prince gave further support to the concealment scheme by failing to file reports required by Exchange Act § 16(a) and Rule 16a-3 disclosing his holdings and transactions in ISI securities,[4] reports which also would have exposed his involvement at ISI.

C. The Complaint's First Two Claims for Violations of the Securities Laws' Antifraud Provisions State Claims on Which Relief May Be Granted

The first two claims allege that each defendant violated Securities Act § 17(a)[5] and Exchange Act § 10(b) and Rule 10b-5.[6]

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[3] In addition to Prince's identity, the relevant provisions of the federal securities laws required ISI to disclose Prince's business experience; Prince's legal background including certain criminal convictions and injunctive orders; his compensation; and the fact that he had not filed the required reports concerning his holdings and transactions in ISI securities. *See* Regulation S-K, Items 401, 402, 403, 405.

[4] Exchange Act § 16(a) requires directors and officers of public companies, among others, to file statements concerning their holdings in the issuer. Exchange Act Rule 16a-1(f) defines "officer" for this provision to include "an issuer's president, principal financial officer (or, if there is no such accounting officer, the controller), any vice president of the issuer in charge of a principal business unit, division or function (such as sales, administration, or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the issuer." Initial reports on Forms 3 are due within ten days after becoming an officer; annual reports on Form 5 are due within 45 days after the close of the issuer's fiscal year; and interim reports are due within two days after a change in beneficial ownership occurs. *See* Exchange Act § 16(a) and Rule 16a-3.

[5] Section 17(a) of the Securities Act provides, in relevant part:

It shall be unlawful for any person in the offer or sale of any securities by the use or any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly -

(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon the purchaser.

[6] Section 10(b) of the Exchange Act provides, in pertinent part:
It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails, or 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.

Rule 10b-5 provides, in relevant part:

1. The First and Second Claims for Violations of the General Antifraud Provisions Are Sufficiently Stated

The elements of Securities Act § 17(a) largely parallel the elements of Exchange Act § 10(b) and Rule 10b-5. In general, to prove a claim under these provisions, plaintiff must show that the defendant (1) committed a deceptive or manipulative act, or made a material misrepresentation or omission; (2) with scienter; (3) which affected the market for securities or was otherwise in connection with their offer, sale or purchase. *See SEC v. Power*, 525 F. Supp.2d 415, 419 (S.D.N.Y. 2007); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 491-92 (S.D.N.Y. 2005); *SEC v. First Jersey Sec., Inc.*, 890 F. Supp. 1185, 1209 (S.D.N.Y. 1995), *aff'd in part and rev'd in part*, 101 F.3d 1450 (2d Cir. 1996). However, proof of scienter is not required for liability under Securities Act § 17(a)(2) and § 17(a)(3), as liability for these sections may be based on negligent conduct.[7]

a. The Violation of Section 17(a) Is Properly Stated

Defendants Chamberlain and Brown each argue that the Complaint fails to state a claim for relief under Section 17(a), purportedly because it fails to allege a particular "offer or sale" in which the fraud occurred. *See* Chamberlain Motion at 7-9; Brown Motion at 26-28. Defendants incorrectly assert that a specific offer or sale of securities must be pled under Section 17(a).

Defendants' failure to find supporting authority for their argument is telling. The complaint alleges that ISI is a public company, whose stock is registered with the Commission

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It shall be unlawful or any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,
(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

[7] *See Aaron v. SEC*, 446 U.S. 680, 697 (1980); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996).

and trades on the NASDAQ Global Select Market. Complaint ¶ 17. It alleges repeated misstatements and omissions concerning Prince in ISI's filings with the Commission, specifically, in seven ISI annual reports and seven ISI proxy statements. Complaint ¶¶ 32, 55. This suffices to state a Section 17(a) claim. Where, as here, the alleged misstatements occur in public filings, *i.e.*, ISI's annual reports and proxy statements, "the scope of the two sections [Exchange Act § 10(b) and Securities Act § 17(a)] is essentially coextensive because the fraudulent conduct touches upon both purchases and sales of publicly-traded securities." *SEC v Wolfson*, 539 F.3d 1249, 1257 (10th Cir. 2008); *see SEC v Power*, 525 F. Supp. 2d 415, 419-20 (S.D.N.Y. 2007)("A public company and its management may violate these provisions by making a material misstatement in, or omitting material information from, a periodic report, registration statement, or other filing with the Commission"); *SEC v. Goldsworthy*, No. 06-cv-10012-JGD, slip op. at 25 (D. Mass. June 11, 2008) ("where a defendant has made false or misleading statements in materials typically relied upon by investors engaged in the ordinary market trading of securities, the requirement [of Section 17(a)] that fraud occur "in the offer or sale" is satisfied").[8]

2. <u>The Complaint Satisfies Rule 9(b)'s Standard</u>

Defendants Chamberlain and Brown also argue that the Complaint does not meet the pleading standard in Rule 9(b), Fed. R. Civ. P., that requires "the circumstances constituting

[8] Defendants' argument that there is a significant difference between the two statutes flies in the face of the Supreme Court's statement in *U.S. v Naftalin*, 441 U.S. 768 (1979), that Congress intended the terms "offer" and "sale" in Section 17(a) be defined broadly, encompassing the entire selling process, and was skeptical that Section 17(a)'s "in the offer or sale" language connoted any narrower range of activities than those covered by the "in connection with the purchase or sale" language in Rule 10(b). *Naftalin*, 441 U.S. at 773 and *id.*, n. 4. The *Naftalin* Court noted that the statute was designed "to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading." *Id.* at 778.

fraud or mistake" to be stated with particularity when fraud is alleged.[9] *See* Chamberlain Motion at 22-28; Brown Motion at 7-11. Rule 9(b) requires that the complaint should identify the false statements, give the particulars as to why it contends the statements were false, and identify those responsible for the statements. *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 95 (2d Cir. 2001). However, the rule is not intended to be "an insurmountable hurdle for [claimants] to overcome, but was designed to afford defendants fair notice of the fraud alleged against them." *Lehman Bros. Commercial Corp. v. Minmetals Int'l,* No 94-civ-8301 (JFK), 1995 WL 608323 (S.D.N.Y. Oct. 16, 1995) (denying motion to dismiss); *see also Ross v. Bolton*, 904 F.2d 819, 823 (2d Cir. 1990) ("The primary purpose of Rule 9(b) is to afford defendant fair notice of the plaintiff's claim and the factual ground upon which it is based"). As shown below, the Complaint gives defendants more than the fair notice required under Rule 9(b), and clearly states the "who, what, when, where and why" of the alleged fraud.[10]

a. <u>The Complaint Alleges Misrepresentations and Omissions ("What, When and Where") with Particularity</u>

The Complaint alleges that the federal securities laws require the disclosure of specific information by public companies in their annual reports and proxy statements, including 1) the identity of its executive officers and significant employees and their roles at the company; 2) their business experience; 3) their significant legal history, including specifically certain criminal

[9] Rule 9(b) states that "malice, intent, knowledge" and other states of mind may be alleged generally. Defendants do not appear to contend that the Complaint fails to allege scienter. Scienter (like all mental states) is typically proved by circumstantial evidence. *See SEC v. US Envt'l*, No. 94-civ-6608-PKL, 2003 WL 21697891, at *22 (S.D.N.Y. July 21, 2003) ("The Court of Appeals [in *Herman & Maclean v. Huddleston*, 640 F.2d 534 (5th Cir. 1981)] also noted that the proof of scienter required in fraud cases is often a matter of inference from circumstantial evidence. If anything, the difficulty of proving defendant's state of mind supports a lower standard of proof. In any event, we have noted elsewhere that circumstantial evidence can be more than sufficient") (*quoting Herman & Maclean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983), *aff'd*, 114 F. App'x 426 (2d Cir. 2004). Scienter is amply alleged, both specifically and circumstantially. *See* Complaint, ¶ 32-35, 41, 44.

[10] Pursuant to rule 9(b), a complaint should "(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." *Rombach v. Chang*, 355 F.3d 164, 170 (2d Cir. 2004).

convictions and injunctive orders; 4) the identity of highly compensated persons "serving as officers" of the company; and 5) the identity of individuals required to report their holdings and transactions in company stock who have not filed such reports. Complaint, ¶¶ 6, 7, 33, 35. Officers of public companies are required to promptly and timely report their holdings and transactions in the company's stock. Complaint, ¶¶ 8, 29. From December 1998 until August 4, 2006, Prince failed to timely file the Section 16(a) forms with the Commission concerning his holdings and transactions in ISI securities (¶ 8, 29, 60), which gives rise to the fair inference that Prince was concealing his *de facto* officer status to the public by failing to file the forms.

Seven annual reports for ISI, filed with the Commission on Forms 10-KSB or Forms 10-K between December 1999 and mid-2006, failed to identify Prince as an executive officer or otherwise, nor did these seven annual reports make any of the required disclosures concerning Prince's role in the company, business experience, or legal background. Complaint, ¶¶ 7, 32. Moreover, none of these seven annual reports disclosed that Prince had failed to make the required Section 16(a) filings with the Commission. Complaint, ¶ 33.

The Complaint also alleges that from 2000 to March 2006, ISI filed seven proxy statements with the Commission soliciting votes for, among others, defendant Chamberlain. These proxy statements were false in that they omitted mention of Prince in ISI's listing of executive officers and highly compensated individuals "serving as officers;" they also were false in that they represented that the company's officers had complied with Section 16(a)'s requirements to disclose their holdings and transactions in ISI securities, but did not mention Prince's non-compliance; and they were false in that they incorporated the ISI annual reports that contained misstatements and omissions concerning Prince. Complaint, ¶ 35, 55.

b. <u>The Complaint Alleges Falsity ("Why") with Particularity</u>

The Complaint alleges numerous facts that demonstrate that the misstatements and omissions above were false and misleading, in that Prince had sufficient authority and responsibility within ISI to require disclosure to the public under the federal securities laws. The Complaint alleges that after Prince was re-hired by Chamberlain in 1998, Prince functioned as an executive officer of ISI and was often among the highest compensated individuals at the company. Complaint, ¶¶ 7, 28. Prince was given broad authority and responsibility in conducting the company's management, strategic planning, policy making, and financial reporting functions. Complaint, ¶ 3. Most tellingly, Prince was listed on ISI's organizational charts at the level of "Executive Vice President." Complaint, ¶ 4. To conceal Prince from the investing public, Chamberlain was careful not to give Prince a title that would betray his executive officer status. ¶ 22. However, Prince reported directly to CEO Chamberlain like other executive officers, and was Chamberlain's close advisor. *Id.* Prince's office was located in the same area as were the offices of the other titled ISI officers. Complaint, ¶ 24. Prince received an indemnification agreement and a change-in-control agreement from ISI, like other titled ISI officers. *Id.* Prince prepared recommendations to Chamberlain concerning the annual salary increases and bonuses for all senior managers at ISI. Complaint, ¶ 22. Prince was a member of the policy setting group at ISI comprised of its most senior most executive officers, all of whom - except for Prince - had titles of Executive Vice President or higher. Complaint, ¶ 23. Prince directed ISI's mergers and acquisition program; oversaw the subsidiaries that ISI acquired with the heads of the acquired companies reporting to Prince; and made operational decisions for those subsidiaries concerning expenditures and hiring and firing of personnel. Complaint, ¶ 25. Prince was a director of ISI's acquisition vehicle and the Chairman of the Board of Newpoint

Technologies, an ISI subsidiary. *Id.* In 2005, Prince had the authority to approve major contracts for and major expenditures by ISI and became head of ISI's Contracts Department. Complaint, ¶ 26. Prince was one of only three members of ISI's senior management to give regular presentations concerning ISI to the Board of Directors. Complaint ¶¶ 4, 27. Prince drafted and prepared the Management Discussion and Analysis ("MD&A") sections of ISI's annual reports, and reviewed, commented on, and approved ISI's draft annual reports and proxy statements. Complaint ¶¶ 35, 39. When ISI finally disclosed Prince's identity and role in the company in 2006, he was identified by the title "Executive Vice President and Managing Director of Operations." Complaint ¶ 31.

c. <u>The Complaint Alleges Responsibility for the Fraud ("Who") with Particularity</u>

The Complaint more than adequately alleges that the defendants are responsible for the misstatements and omissions in the seven annual reports and seven proxy statements. The Complaint also alleges that all defendants reviewed the annual reports, and specifically alleges that Prince reviewed, commented on, and approved all of ISI's draft annual reports. Complaint, ¶¶ 7, 32, 33, 39. All of the seven annual reports were signed by Chamberlain, and all, except the first annual report (the 1999 Form 10-KSB), were also signed by Brown. Complaint, ¶ 32. Chamberlain and Brown also certified each annual report for fiscal years 2002, 2003, 2004, and 2005. Complaint, ¶¶ 34, 51. The Complaint alleges that defendant Chamberlain solicited proxy votes using the seven proxy statements filed by ISI from 2000 through mid-2006, and that all of the defendants reviewed the proxy statements, and that defendants Brown and Prince prepared and approved materials in those proxy statements, including the incorporated periodic reports, that failed to identify Prince or to disclose any of the required information about him. Complaint, ¶¶ 7, 35, 55, 57.

3. The Complaint Adequately Alleges Prince's Primary Liability

Prince argues that he cannot be primarily liable for violation of the antifraud provisions (apparently because he did not sign the false filings), even though he admits that the Complaint alleges his intimate involvement in the drafting, reviewing, commenting upon, and approval of the filings. Prince Motion at 7-11. Because, according to Prince, he did not "make" any false statements, Prince urges the Court to adopt a so-called "bright line test" from Second Circuit case law under which primary liability exists only when the statement is publicly attributed to the actor. *Id.* at 8.

This argument lacks merit. To begin, even the Second Circuit, where the test is supposedly applied, does not require in all cases that the misstatements be attributed to the defendant for primary liability to attach. Indeed, as Judge Lynch observed:

> The Second Circuit decisions after Central Bank [of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994)] have generally applied its holding by allowing dismissing claims against outside professionals who provided necessary services to the fraudsters, but allowing claims to proceed against inside actors who actively participated in or orchestrated the fraudulent scheme alleged, even if they did not personally make the false statements or personally execute the mechanics of the manipulation.

In re Salomon Analysts AT&T Litig., 350 F. Supp.2d 455, 473 (S.D.N.Y. 2004) (emphasis supplied); *see also Levitt v. Bear Stearns & Co., Inc.*, 340 F.3d 94, 103 (2d Cir. 2003)("a primary violator is one who 'participated in the fraudulent scheme' or other activity proscribed by the securities laws") *citing SEC v. U.S. Envt'l, Inc.*, 155 F.3d 107, 111 (2d Cir.1998) (*quoting First Jersey Secs., Inc.*, 101 F.3d at 1471).

As an "inside actor who actively participated in or orchestrated the fraudulent scheme," Prince is primarily liable for violation of the antifraud provisions. Moreover, courts have explicitly and consistently rejected the "attribution" test Prince urges this Court to adopt in SEC

enforcement actions, recognizing that it arises from the requirement in private securities actions to prove reliance, and is therefore irrelevant here.[11]

Prince is alleged to have participated in a fraudulent scheme to conceal his identity and role at ISI from public investors.[12] Prince was an insider at ISI, ISI's former CFO, close advisor to ISI's CEO, and one of the most powerful individuals at the company. More specifically, Prince drafted, reviewed, commented on, and approved the various filings with the Commission that should have disclosed his identity, role and other required information concerning himself. Prince also failed to file Section 16(a) reports concerning his holdings and transactions in ISI securities, reports which would have signaled to the investing public his significant role at the company. The Commission has adequately alleged primary violations by Prince. *See, e.g.*, *Wolfson*, 539 F.3d at 1261 (defendant primarily liable who had an integral role in preparing the fraudulent filings with the Commission)*; In re Software Toolworks Inc. Sec. Litig.*, 50 F.3d 615, 625 (9th Cir. 1994)(member of drafting group with access to inside data primarily liable)*; McConville v. SEC*, 465 F.3d 780, 787-88 (7th Cir. 2006)(former CFO who drafted, reviewed and approved drafts of company Form 10-K filing primarily liable); *In re Scholastic Corp. Sec.*

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[11] *See SEC v. Wolfson*, 539 F.3d 1249, 1259-60 (10th Cir. 2008) ("Requiring the government to prove attribution in a *public* enforcement action thus directly conflicts with our jurisprudence recognizing that the SEC need not plead and prove reliance in a § 10(b) case"); *SEC v KPMG*, 412 F. Supp. 2d 349, 375 SDNY 2006) ("[I]n an SEC enforcement action, there appears to be no reason to impose a requirement that a misstatement have been publicly attributed to a defendant for liability to attach, at least so long as the SEC is able to show that the defendant was sufficiently responsible for the statement-in effect, caused the statement to be made - and knew or had reason to know that the statement would be disseminated to investors"). Though Prince is aware that numerous courts have found that primary liability to exist in circumstances similar to his, he urges the Court to disregard those cases as involving wrongful conduct that is "simply in a different universe." Prince Motion at 11 n.8. Prince's failure to offer a principle to distinguish his situation from those decisions betrays his argument's lack of merit. In this universe, Prince is properly alleged to be primarily liable for violations of the securities laws' antifraud provisions.

[12] As one court recently explained, in a fraudulent scheme:

> Several persons may act in concert to commit a violation of section 10(b) that might not be actionable were it not for their cooperation. For example, if one person were to *create* a false prospectus knowing that it would be transmitted to investors, and another were to then *transmit* that prospectus to investors knowing it to be false, each individual would have contravened the text of section 10(b) by employing a fraudulent device in connection with the sale of securities.

SEC v. Collins & Aikman Corp., 524 F.Supp.2d 477, 486-87 (S.D.N.Y. 2007).

Litig., 252 F.3d 63, 75-76 (2d Cir. 2001) (vice president was primarily liable for statements he was "involved in drafting, producing, reviewing, and/or disseminating").

4. <u>The Complaint Adequately Alleges A Duty</u>

Prince also argues that he has no duty related to the misstatements and omissions in ISI's filings with the Commission. Prince Motion at 12-13. Prince is also incorrect here. As discussed above, Prince is alleged to be an insider at ISI primarily liable for the misrepresentations and omissions in ISI's filings. The Complaint alleges that the federal securities laws impose a duty to provide certain disclosures concerning Prince. And, once the misleading ISI filings were made, omitting the information concerning Prince, he was under a duty to correct the misstatements.[13]

5. <u>The Complaint Adequately Alleges Prince's Involvement in a Fraudulent Scheme</u>

The Complaint states claims against each defendant based on all three subsections of Section 17(a), and all three subsections of Rule 10b-5. Complaint ¶¶ 41, 44. Defendant Prince asserts that he cannot be liable for violation of the antifraud provisions because he did not "commit any manipulative or deceptive acts," which he defines to consist solely of "practices such as 'wash sales, matched orders, or rigged prices.'" *See* Prince Motion at 13-15. Prince also complains that he could not be involved in a scheme to conceal his role at ISI, given the Complaint's allegations concerning his involvement in ISI's management. *Id.* at 15 – 16.

Prince is incorrect again; there is no requirement that a specific "fraudulent device" be alleged under Rule 10b-5(a) and Section 17(a)(1). These sections require only that the defendant, directly or indirectly, used "a device, scheme <u>or</u> artifice to defraud" (emphasis added).

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[13] *See Schlifke v. Seafirst Corp.*, 866 F.2d 935, 944 (7th Cir. 1989)("[i]ncomplete disclosures, or 'half truths,' implicate a duty to disclose whatever additional information is necessary to rectify the misleading statements"); *see also Roeder v. Alpha Indus., Inc.*, 814 F.2d 22, 26 (1st Cir. 1987); *Karacand v. Edwards*, 53 F. Supp.2d 1236, 1243 (D. Utah 1999); *cf. U.S. v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991) (duty to file under Section 13(d) "creates a duty to file truthfully and completely").

All defendants are alleged to have engaged in a scheme to conceal Prince's substantial role at ISI from the investing public, a scheme furthered by, the filing of fraudulent and misleading annual reports and proxy statements that failed to identify Prince or provide any of the required information about Prince. Until August 4, 2006, four days before ISI disclosed that Prince was an Executive Vice President, Prince failed to comply with Section 16(a) and file reports concerning his ISI holdings and transactions. Prince's contention that his extensive authority was well-known and notorious inside ISI misses the point: the scheme was designed to defraud the investing public, which receives its information about the company's internal management from the filings with the Commission, not to deceive ISI employees who worked under Prince. In short, Prince engaged in deceptive conduct in connection with the filings, which renders him liable under Rule 10b-5(a) and Section 17(a)(1).[14] *See also SEC v Collins & Aikman Corp.*, 524 F. Supp. 2d 477, 486-87 (S.D.N.Y. 2007)(a false prospectus can be a fraudulent device utilized in a scheme to defraud).

D. <u>The Fourth Claim Against Chamberlain and Brown for False Certifications Is Proper</u>

The Fourth Claim for Relief alleges that Chamberlain and Brown violated Exchange Act Rule 13a-14 by falsely certifying that ISI's 2002 through 2005 annual reports. Defendants Chamberlain and Brown contend that the Commission cannot bring an action to enforce that statute directly. *See* Chamberlain Motion at 10-13; Brown Motion at 28-31.

Nothing can be further from the truth. Exchange Act § 21(d)(1) provides that the Commission may bring an action in U.S. District Court to enjoin acts or practices that violate "any provision of this title, the rules or regulations thereunder." *See also* Complaint ¶¶ 11-12 (pleading jurisdictional provisions of the Securities and Exchange Act). Rule 13a-14 provides

[14] This conduct in concealing Prince's role at ISI from the public is also suffices to allege acts, transactions, practices, or course of businesses that operate as a fraud for the purposes of Rule 10b-5(c) and Section 17(a)(3).

that the principal executive and principal financial officers of a public company must certify each annual report as true, accurate, and complete. Since Rule 13a-14 became law, the Commission has brought, and prevailed on, many cases that included Rule 13a-14 claims.[15]

Chamberlain and Brown point to a decision in the Northern District of Illinois in which the District Court granted the SEC's motion for summary judgment, injunctive relief and an officer and director bar on all grounds except Rule 13a-14 to support their argument. *See SEC v Black*, No. 04-C-7337, 2008 WL 4394891 (N.D. Ill. Sept. 24, 2008).[16] Defendants' reliance on *Black*, however, is misplaced. No other court has followed the *Black* court's reasoning. The *Black* court's reasoning is suspect, in part because it relies on decisions in two *private* securities law actions – one of which held that Rule 13a-14 did not create a *private cause of action*, and the other simply held that a false certification was not itself per se evidence of a violation of Section 10(b). *See Black*, 2008 WL 4394891 at *16-*17. Neither decision directly addressed the issue of the Commission's right to bring an action to enforce Rule 13a-14. Nor did the *Black* court examine the difference between the Commission's statutory authority to seek relief for violation

[15] *See, e.g., SEC v. Miller et al.*, No. 09-Civ-4945 (S.D.N.Y. May 28, 2009)(final judgment for violation of Rule 13a-14)*; SEC v Standard*, No. 06-cv-7736-GEL, 2009 WL 196023 at *28 (S.D.N.Y. Jan. 27, 2009)(finding, after bench trial, that CEO violated Exchange Act Rule 13a-14); *SEC v Indigenous Global Development Corporation, et al*., No. C-06-05600 JCS, 2008 U.S. Dist. Lexis 50434 ,at *43-*44 (N.D. Cal. June 30, 2008) (granting summary judgment for Commission, and finding that CEO violated Rule 13a-14); *SEC v Fischer*, No. C07-03945-HRL (N.D. Ca. Sept. 18, 2007)(final judgment for violation of 13a-14); *SEC v Brady*, 2006 WL 1310320 at *5, No. 05-cv-1416 (N.D. Tex. May 12, 2006)(denying motion to dismiss Rule 13a-14 claim); *SEC v. Sandifur*, 2006 WL 538210 at *8, No. C05-1631C, (W.D. Wash. March 2, 2006)(denying motion to dismiss Rule 13a-14 claim*); SEC v Syndicated Food Service Int'l*, No. 04-CV-1303-NGG, slip. Op. (S.D.N.Y. Feb. 14, 2005)(denying motion to dismiss Rule 13a-14 claim).

[16] The fact that the Commission prevailed on all other grounds, and obtained the requested relief, in *Black* suggests that the decision not to appeal the *Black* court's decision has little, if any significance, with regard to the merits of its decision on the Rule 13a-14 claim. *See* Brown's Motion at 31 (arguing failure to appeal significant).

of any section or regulation of the federal securities laws and the lack of a similarly empowering mechanism for private litigants.[17]

As the Commission is entitled to bring this action to enforce Rule 13a-14, defendants' motions to dismiss the Fourth Claim for Relief should be denied.

E. The Fifth Claim for Relief (Proxy Violations) Is Properly Charged

The Fifth Claim alleges that Chamberlain violated, and Brown and Prince aided and abetted violations of the proxy provisions of the Exchange Act, Section 14(a) and Rule 14a-9.[18]

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[17] As noted above, Exchange Act § 21(d)(1) creates the cause of action for the Commission to enforce any rule promulgated under the Exchange Act, including Rule 13a-14; no similar provision exists for private litigants. The final basis for the *Black* court's decision was a reading of a Commission's release accompanying the final rule which it concluded indicated that the Commission would not directly enforce the rule. *See Black*, 2008 WL 4394891 at *16. However, that language merely emphasizes that an individual violating the rule may also be liable under other provisions of the federal securities laws. *See* SEC Release No. 34-46427, 2002 WL 3170215 at *9 (Aug. 28, 2002) ("An officer providing a false certification potentially could be subject to Commission action for violating Section 13(a) or 15(d) of the Exchange Act and to both Commission and private actions for violating Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5"). That Rule 13a-14 was intended to provide a separate basis of liability for an issuer's CEO and CFO is clear from the Commission's proposing release:

> We do not believe that the proposed certification requirement would change the underlying liability standard as to materiality or create an unacceptable risk of increased liability for a company's principal executive officer and principal financial officer. These senior officers already are responsible as signatories for their company's disclosure under the Exchange Act liability provisions and can be liable for material misstatements or omissions under general antifraud standards and under our authority to seek redress against those who cause or aid or abet securities law violations. The proposed certification requirement would reinforce the responsibility of these corporate officers to security holders for the content of companies' quarterly and annual reports. Similarly, the proposed rule is not intended to affect other existing bases of liability for principal executive officers and principal financial officers or to increase, decrease or otherwise alter the potential liability of other corporate officers and directors, whether or not signatories, who are not required to provide the proposed certification. . . .
>
> In summary, our proposal is consistent with an appropriate level of liability where a principal executive officer or principal financial officer fails to review his or her company's quarterly or annual reports or certifies the accuracy and completeness of these reports when, based on his or her knowledge and belief, the certification is false. We believe that these corporate officers should be involved in the approval process for these reports and that they should not approve them without first reviewing them thoroughly and thinking critically about the disclosure that they should contain.

SEC Release No. 34-46079, 2002 WL 1308237 at *5-*6 (June 14, 2002) (emphasis supplied).

Thus, proposed Rule 13a-14 provided for "an appropriate level of liability" for those falsely certifying annual and quarterly reports. Significantly, the release did not state that the new rule would result in "no risk of increased liability;" instead, the language chosen was that it did not create an "unacceptable risk of increased liability." This is because those required to sign the annual reports, the issuer's CEO and CFO, would in all probability be liable under other Exchange Act provisions if they falsely certified a periodic report, so the possibility that they could violate Rule 13a-14 and would not also violate other provisions of the federal securities laws was minimal. Of course, that is precisely the instant case: Chamberlain (ISI's CEO) and Brown (ISI's CFO) are charged with violations of the securities laws' general antifraud, proxy statement, and reporting provisions for their unlawful conduct, in addition to the false certification claims against them.

1. "Causality" Need Not Be Alleged in a Commission Enforcement Action

Defendants Chamberlain and Brown maintain that the Fifth Claim is deficient because it fails to include a requirement they urge this Court to adopt from private securities actions: that there is an "essential link," or causal relationship, between the misstatements and omissions in the proxy statements and the matters voted upon. *See* Chamberlain Motion at 14-17; Brown Motion at 31-32.

The Court should reject this argument. Defendants have obfuscated a core difference between Commission public securities law enforcement actions and private securities laws actions. In an action such as this one, "[t]he Commission's duty is to enforce the remedial and preventative portions of the statute in the public interest, and not merely those whose plain violations have already caused demonstrable loss or injury." *Berko v. Securities and Exchange Commission*, 316 F.2d 137, 143 (2d Cir. 1963)(emphasis supplied)(holding that whether customers were misled or lost money from boiler-room salesman's recommendations "legally irrelevant"). It is settled law that the Commission need not establish reliance upon a defendant's misrepresentations or omissions, nor any damages resulting therefrom. *See SEC v. Rana Research Inc.*, 8 F.3d 1358, 1363 n.4 (9th Cir. 1993); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985); *SEC v Credit Bancorp, Ltd.*, 195 F. Supp. 2d 475, 490-91 (S.D.N.Y. 2002). The Commission's actions to vindicate the federal securities laws need only establish the breach of those laws - here, the existence of material misstatements or omissions in the proxy statements

[18] Exchange Act § 14(a) and Rule 14a-9 prohibit, *inter alia*, the solicitation of proxies by means of any proxy statement:

> "which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading …"

and the defendants' responsibility for those misstatements or omissions.[19] Consequently, the Fifth Claim is properly stated.

2. Materiality Is Adequately Alleged

Defendant Chamberlain complains that the Commission has not alleged that the misrepresentations and omissions in the proxy statements were material. *See* Chamberlain Motion at 18-20. On a Rule 12(b)(6) motion, "a plaintiff satisfies the materiality requirement of Rule 10b-5 by alleging a statement or omission that a reasonable investor would have considered significant in making investment decisions." *Ganino v Citizens Utility Co.*, 228 F.3d 154, 161 (2d Cir. 2000). Because materiality is a mixed question of law and fact, and "a complaint may not properly be dismissed ... on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Ganino,* 228 F.3d at 162. *See also SEC v. Buntrock*, No. 02-c-2180, 2004 WL 1179423 at * 5 (N.D. Ill. May 25, 2004)(materiality of misrepresentations best left to trier of fact).

The fact that the Commission's rules require disclosure of this information is strong evidence of its materiality. *See SEC v. Levy, 706 F. Supp. 61, 72 (D.D.C. 1989); see also U.S. v. Bilzerian,* 925 F.2d 1285, 1298 (2d Cir. 1991); *In re Browning-Ferris Indus. Inc.*, 830 F. Supp. 361, 367 (S.D. Tex. 1993). As a practical matter, information that Prince: had been convicted of criminal securities fraud; was enjoined by this Court from committing securities fraud; had been ordered not to practice before the Commission as an accountant; worked in financial reporting at Financial News Network; was one of the most highly compensated individuals at the company;

[19] Though it need not establish an "essential link" between the omission of information concerning Prince's role in the company, business experience, legal background and compliance with the stock disclosure provisions, such information would have likely been material to shareholders in determining whether or not to vote for Chamberlain.

and was non-compliant with Section 16(a), would have undoubtedly "altered the total mix of information" available to the shareholder in considering whether or not to vote for Chamberlain (who had, after all, re-hired Prince).[20] In a case involving facts similar to those at bar, the District Court for the Southern District of New York found a failure to disclose a consultant's involvement in the company to be material. *See, e.g., SEC v Enterprises Solutions, Inc.*, 142 F. Supp.2d 561, 573 (S.D.N.Y. 2001)(given consultant's "extensive history of criminal and regulatory violations, disclosure of his significant participation in the company would have certainly altered the 'total mix' of information available to a reasonable shareholder").

F. <u>The Five Year "Look Back" in Regulation S-K Does Not Bar Any Claims</u>

Defendants Chamberlain and Brown assert that disclosure of Prince's legal background was not necessary after 2002, five years following his conviction, and seek dismissal of all claims based on the failure to disclose his legal background after June 2002. Chamberlain Motion at 31; Brown Motion at 21-26.

While the guiding regulations direct disclosure of the legal history of an executive officer or significant employee for the previous five years, *see* Regulation S-K, Item 401, the fact that five years have passed does not necessarily mean that the information is no longer material. The test is whether there is "a substantial likelihood that a reasonable investor would consider it important," <u>not</u> whether five years have passed since the event.[21] In fact, ISI disclosed Prince's criminal history when it filed its Form 8-K disclosing Prince's identity and role as an Executive Vice President on August 8, 2006, a date approximately <u>nine</u> years after Commission's 1997

[20] These disclosures are required by Exchange Act Rules 14a-3, 14a-101, and Regulation S-K.

[21] *See, e.g., SEC v. TLC Investments*, 179 F. Supp. 2d 1149, 1153 *(*C.D. Cal. 2001) (six year old undisclosed tax fraud conviction material)*; Enterprises Solutions*, 142 F. Supp.2d at 574 (legal history more than six years prior to registration statement).

order. *See* Complaint, ¶ 31. Moreover, the Commission believes that the evidence adduced during discovery will show that ISI's own lawyers advised that Prince's criminal history was material and would need to be disclosed after June 2002 if he were included in the company's executive officers. Faced with this advice, the defendants continued in their scheme to fraudulently conceal Prince's involvement at ISI as a de facto executive officer after June 2002.

Even assuming, *arguendo*, Prince's legal history did not need to be disclosed as material information after June 2002, there were other disclosures the defendants failed to make concerning Prince, including the most basic: Prince's identity and role in the company, as well as his compensation, and fact that Prince had not complied with Section 16(a). Consequently, this argument is devoid of merit.[22]

G. Defendants' Void for Vagueness Argument is Meritless

Defendants Chamberlain and Brown argue that the term "officer" is void for vagueness, and provides no notice of Prince's status as an ISI officer or executive officer, and that therefore all claims should be dismissed. Chamberlain Motion at 32-33; Brown Motion at 11-14.

This argument is spurious. "Void for vagueness" is a high standard to meet in a civil case alleging violation of an economic law. As the Supreme Court explained in *Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982), this is because, among other reasons:

> [the] subject matter [of economic law] is often more narrow, and because *businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action.* Indeed, the regulated enterprise may have *the ability to clarify the meaning* of the regulation by its own inquiry, or by resort to an administrative process.

[22] Defendant Brown also claims that aiding and abetting charge against her is insufficiently specific as to the "required information" omitted from the proxy statements. Brown Motion at 31. As previously discussed, the Complaint amply specifies that information. *See* Argument, Section I.C.2.c, *supra*.

(Emphasis supplied). The Commission expects that the evidence in this case will show that the defendants not only had the ability to consult counsel to clarify whether and how to disclose Prince's involvement at ISI, but in fact did consult counsel, and were informed that they would need to disclose his criminal history even after June 2002.

Moreover, the terms "officer" and "executive officer" are both defined in the Exchange Act, *see* Exchange Act Rules 3b-2 & 3b-7,[23] and the term "officer" is again specifically defined for purposes of Section 16(a) compliance. See Exchange Act Rule 16a-1(f).[24] These definitions are extensive and detailed. Defendants cannot plausibly contend that these definitions are unconstitutionally vague, leaving them with no recourse but to "guess" whether Prince's duties, authority, and conduct placed him within those definitions. The Complaint's allegations show clearly that Prince was an officer as well as an executive officer of ISI.[25]

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[23] Rule 3b-2 provides:
Definition of "Officer"

> The term *officer* means a president, vice president, secretary, treasurer or principal financial officer, comptroller, or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated.

Rule 3b-7 provides:
Definition of "Executive Officer"

> The term *executive officer*, when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration, or finance), and any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy making functions for the registrant.

[24] Rule 16a-1(f) provides, in relevant part:
The term "officer" shall mean an issuer's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy making functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy making functions for the issuer….
NOTE: "Policy-making function" is not intended to include policy-making functions that are not significant. If pursuant to Item 401(b) of Regulation S-K (17 C.F.R. 229.401(b)) the issuer identifies a person as an "executive officer," it is presumed that the persons so identified are officers for the purposes of Section 16 of the Act, as are such other persons enumerated in this paragraph (f) but not in Item 401(b).

[25] See discussion Section I.C.2.b, *supra*. As the Supreme Court has stated, "[o]ne to whose conduct a statute clearly applies may not successfully challenge it for vagueness." *Parker v. Levy*, 417 U.S. 733, 756 (1974).

The question is essentially one of fact, which courts have resolved with no difficulty in the past. *See SEC v. Solucorp*, 274 F.Supp. 2d 379, 420 (S.D.N.Y. 2003) (finding that "consultant" was a *de facto* officer for purposes of Section 16(a) where "he performed duties analogous to those of an officer and had access to insider information…"); *Enterprises Solutions*, 142 F. Supp. 2d at 574 (finding defendant's duties to be consistent with that of an officer or director requiring his disclosure)("A company cannot lawfully hide a significant figure in the management of the company behind the vague title 'consultant.'"); *cf. Colby v. Klune*, 178 F.2d 872, 873 (2d Cir. 1949)(interpreting the rule defining an officer for purposes of Section 16 as "a corporate employee performing important executive duties of such character that he would be likely, in discharging those duties, to obtain confidential information about the company's affairs that would aid him if he engaged in personal market transactions").

II.

28 U.S.C. SECTION 2462 DOES NOT BAR THE COMMISSION'S REQUESTED RELIEF NOR LIMIT EVIDENCE

A. Section 2462 Does Not Apply at All to the Commission's Claims for Injunctive Relief or Officer and Director Bars Against the Defendants

Defendants Chamberlain and Brown asserts that 28 U.S.C. Section 2462 bars the Commission from recovering civil penalties, injunctive relief, or an officer and director bar in this case, and consequently requires this Court to grant their motions to dismiss those claims**.** Chamberlain Motion at 28-29; Brown Motion at 14-21. Defendants are wrong.

Section 2462 states that an action seeking the enforcement of "any civil fine, penalty, or forfeiture, pecuniary or otherwise" must commence within five years from the date the claim

first accrued. It is settled that the statute does not apply to claims for equitable relief, including injunctive relief and officer and director bars.[26]

This is so because injunctions and officer and director bars are considered "remedial" in nature, and are not imposed by district courts as punishments. Indeed, the factors a court must consider in determining whether to grant injunctive relief and an officer and director bar are explicitly equitable in nature. *See, e.g., SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995) (enumerating factors, including likelihood of recurrence and degree of scienter).[27]

B. Section 2462 Does Not Bar the Commission's Request for Civil Penalties or Preclude the Court from Considering Evidence in Determining That Request

Section 2462 does not bar the Commission's request for civil penalties for a number of reasons. The most obvious reason is that the Complaint is timely under Section 2462. The complaint alleges a fraudulent scheme extending from approximately December 1998 to August 2006. The Complaint was filed on July 30, 2009, well within the five year statute of limitations.

[26] *See, e.g., SEC v Kelly et al.*, No. 08-CV-4612-CM (SDNY Sept. 30, 2009), slip. op. at 16 ("the great weight of case law in this jurisdiction supports the SEC's contention that equitable remedies are exempted from Section 2462's limitations period"), *citing SEC v McCaskey*, 56 F. Supp. 2d 323, 236 (SDNY 1999)(limitation does not apply to requests for injunctive relief, disgorgement, and officer and director bar); *see also SEC v Posner*, 16 F.3d 520, 522 (2d Cir. 1994) (district court's officer and director bar order "was within the court's well-established equitable power"); *SEC v. Tandem Mgmt. Inc.*, No. 95-civ-8411 (JGK), 2001 WL 1488218 at *6 (S.D.N.Y. Nov. 21, 2001) ("Courts have found that SEC suits for equitable and remedial relief, including requests for permanent injunctions and disgorgement, are not governed by § 2462 because they are not actions or proceedings for a 'penalty' within the meaning of the statute"); *SEC v Schiffer*, No. 9-civ-5853, 1998 WL 226101 at *2 (SDNY May 5, 1998)(Section 2462 not applicable to remedy of officer and director bar); *SEC v. Lorin*, 869 F. Supp. 1117, 1120-23 (SDNY 1994)(not applicable to injunctive relief and disgorgement).

[27] Defendants assert that the Commission's claim for an officer and director bar is a punitive sanction and therefore subject to Section 2462, *citing Johnson v. SEC*, 87 F.3d 484 (D.C.Cir.1996). *Johnson* is not controlling authority on this issue, as that case involved the review of a Commission order suspending the appellant's securities law license as a result of her past securities law violations. Unlike the suspension order in *Johnson*, the officer and director bar is fashioned by the Court after a consideration of a number of factors, and explicitly serves to protect against future public harm based on an assessment of the defendant's risk of causing future harm. Consequently, the officer and director bar remedy is not subject to Section 2462. *See* Johnson, 87 F.3d at 489 (observing that the sanction there "would less resemble punishment" had it focused on the appellant's "current competence or the degree of risk she posed to the public").

1. The Fraudulent Concealment and Continuing Violation Doctrines Toll the Limitations Period, Allowing the Court to Consider All Conduct Relevant to the Commission's Claims for Civil Penalties

Defendants argue that Section 2462 precludes this Court's consideration of events occurring more than five years before the Complaint was filed in considering the Commission's claim for civil money penalties. Under settled case law, however, this Court will be able to consider all relevant evidence concerning their scheme.

As discussed above, the Complaint alleges a scheme to conceal a *de facto* executive officer (defendant Prince). This was done, among other ways, by omitting any reference to that officer in any of the fourteen annual reports or proxy statements the defendants made with the Commission during the relevant period. These filings were reviewed by all defendants, and all the annual reports (except the first) were signed by both defendants Chamberlain and Brown. Moreover, although Prince was required to file reports pursuant to Section 16(a) concerning his holdings and transactions in company stock, he failed to do so until he was "outed" as an Executive Vice President in 2006, thereby avoiding notifying the Commission and alerting the investing public to his significant role at ISI.

Where, as here, the essence of the fraud is to conceal itself, the limitations period is subject to equitable tolling. *See, e.g., Power,* 525 F. Supp. 2d at 426 (fraudulent concealment doctrine tolled statute of limitations on penalty claim) *citing* State of N.Y. *v. Hendrickson Bros., Inc.*, 840 F.2d 1065, 1083-85 (2d Cir. 1988) (statute of limitations tolled by fraudulent concealment both because the fraud was self-concealing and because the evidence of affirmative acts of concealment committed by some defendants was properly admitted against all defendants); *see also SEC v. Mercury Interactive*, No. C-07-2822-JF (N.D. Ca. Sept. 30, 2008),

slip op. at 7 (holding that equitable tolling may exist for concealed fraudulent backdating scheme)(denying motion to dismiss claims or portions of claims as time barred).[28]

In addition, because the complaint alleges a continuing, integrated fraudulent scheme that lasted until August 8, 2006, when Prince's identity and role in the company were finally disclosed, the continuing violation doctrine operates as a matter of law to bring the entire scheme within the limitations period. As the *Schiffer* court explained:

> The [continuing violation] doctrine applies only where a violation, occurring outside of the limitation period, is so closely related to other violations, not time-barred, as to be viewed as part of a continuing practice such that recovery can be had for all violations.

Schiffer, 1998 WL 226101 at *3, *citing Havens Realty Corp. v. Coleman*, 455 U.S. 363, 380-81 (1982). *See also SEC v Kelly*, No. 08-CV-4612-CM, slip op. at 18-19 (S.D.N.Y. Sept. 30, 2009) (holding that continuing violation doctrine tolled the limitations period). Here, the Complaint alleges a continuous scheme to conceal the identity and involvement of Prince at ISI, involving the filing of fraudulent annual reports and proxy statements, commencing as early as December 1998 (when Prince was re-hired) with the last affirmative misstatement occurring in March 2006, in connection the filing of an ISI proxy statement. Complaint, ¶¶ 1, 7, 55.

Accordingly, the Court may consider all of the conduct involved in the scheme in determining civil penalties as a result of the continuing violation doctrine.

[28] The D.C. Court of Appeals has cited the fraudulent concealment doctrine with approval. *See 3M Co. v. Browner*, 17 F.3d 1453, 1461 n.15 (D.C. Cir. 1994).

III.

CONCLUSION

For the foregoing reasons, the defendants' motions to dismiss should be denied.

Dated: October 19, 2009.

Respectfully submitted,

s/ Arthur S. Lowry
Arthur S. Lowry
Jose M. Rodriguez
U.S. Securities and Exchange Commission
100 F St. NE
Washington, DC 20549
(202) 551-4918 (Lowry phone)
(202) 772-9245 (Lowry fax)