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United States District Court, S.D. New York.
SECURITIES AND EXCHANGE COMMISSION, Plaintiff,
v.
Harold GLANTZ and Peter H. Block, Defendants.

No. 94 Civ. 5737 (CSH).
Sept. 20, 1995.

MEMORANDUM OPINION AND ORDER

HAIGHT, District Judge:

***1** This case is before the Court on defendant Peter Block's motion to dismiss the complaint against him for failure to state a claim upon which relief can be granted pursuant to Fed.R.Civ.P. 12(b)(6). I find that such relief is unwarranted, and I deny the motion.

I. BACKGROUND

On August 8, 1994, plaintiff the United States Securities and Exchange Commission ("SEC") filed a civil complaint against defendants Harold Glantz and Peter Block pursuant to Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77q(a)(1), 77q(a)(2), and 77q(a)(3), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5. The SEC alleges that defendants acted in such a manner as to violate these provisions, and seeks equitable relief in the form of an injunction, accounting, disgorgement of ill-gotten gains, and payment of civil penalties.

Glantz is the president of Continental Capital Markets, Inc. ("CCMI"), a Nevada corporation with offices in New York. Block is counsel to Severn Investments Ltd. ("Severn"), formerly known as Penrose International Ltd. ("Penrose"), an investment company in Nassau, Bahamas. The SEC alleges that Glantz and Block acted together as part of a scheme to induce investments from two entities, JMC Enterprises, Inc. ("JMC") and Cardinal Systems, Inc. ("Cardinal"), by telling the investors that their funds would be used to obtain a credit line which would be used to buy, sell, and trade instruments such as prime bank notes ("PBNs"), zero interest credit instruments ("ZICIs"), and zero interest letters of credit ("ZLOCs"). Plaintiff claims that these were all fictitious instruments, and no market exists in which they could be bought, sold or traded.

The SEC's complaint alleges the following specific set of facts: In or about February 1992, Block set forth the details of an investment plan to Jeffrey Cantwell, president of JMC. Block explained to Cantwell that if JMC invested $1 million, Glantz' company, CCMI, would be able to obtain a margin account with a line of credit of $10 to $15 million, which would be used to buy and sell PBNs, ZICIs, and ZLOCs. First Block stated that the credit line would be obtained through Merrill Lynch, but he later told Cantwell that it was to be extended through Swiss Bank Corporation ("Swiss Bank") instead. Block and Glantz both represented to Cantwell that this was a risk-free investment, guaranteeing JMC an annual interest rate of 35%, with payments to be made weekly and the principal investment to be returned after one year. On or about March 23, 1992, Cantwell signed the agreement. On or about March 25, 1992, Cantwell wired the $1 million into an account in the name of JMC at Swiss Bank, over which CCMI had full power of attorney. On or about April 15, 1992, Block informed Cantwell that Glantz was unable to obtain the necessary credit through Swiss Bank, and that the transaction would need to be effected through Bank Julius Baer. In the end of April 1992, Block told Cantwell that there were problems with Julius Baer, and that they would have no trouble obtaining credit if the transactions were through the account of Penrose at Barclays Bank in Nassau, Bahamas. In or about early May 1992, Cantwell signed a new agreement to this effect and transferred his funds to the account of Penrose at Barclays Bank. On or about July 3, 1992, $7,500 was wired to Cantwell's account, which was purportedly the first interest payment. After that date, Cantwell received no more interest payments. From in or about January 1993 to in or about March 1994, Cantwell requested the return of the $1 million principal. On or about March 1, 1994, Glantz ordered a wire transfer of $1 million to Cantwell's personal bank account. Since that date, Block has promised to compensate Cantwell for past due interest.

***2** The SEC alleges similar facts in regard to the second investment procured: In or about November and December 1992, Block told Warren Bradley, president of Cardinal, about an investment plan that was fully safe and would earn an 18% annual interest rate to be paid monthly, with return of the principal investment in one year. Block told Bradley that Cardinal's money would be used to obtain a credit line for the purchase and sale of one year ZLOCs. In or about early December 1992, Bradley signed an agreement, and in or about mid-December 1992, he transferred $40,874.05 of Cardinal's funds to the account of Severn, formerly Penrose, at Barclays Bank in Nassau, Bahamas and $959,125.95 to CCMI's account at Citibank in New York. Later, Glantz used approximately $400,000 of Cardinal's funds for his own personal expenses. Cardinal received no interest payments whatsoever. On or about January 27, 1994, Block sent a letter to Bradley promising the return of the $1 million investment and $200,000 for interest and profits due from the investment, to be paid by June 30, 1994. On or about March 28, 1994, Cardinal received the $1 million, but has not received the $200,000 to date.

The SEC alleges that Glantz and Block knowingly or recklessly committed misrepresentations and omissions of material fact in the above described transactions, which are as follows: (i) Glantz and Block omitted the fact that PBNs, ZICIs, and ZLOCs are fictitious instruments, and that no market exists in which to buy, sell, or trade them; (ii) Contrary to what Glantz and Block told Cantwell, Swiss Bank did not agree to create a line of credit for the purchase and sale of PBNs, ZICIs, or ZLOCs; (iii) Glantz and Block misrepresented the risks associated with the investment and the ability of the investment to produce the promised interest rates; (iv) Glantz did not disclose to Bradley his personal use of Cardinal's funds.

Prior to this action, the United States Attorney's office for the District of Massachusetts filed a six-count indictment against Glantz and two other defendants, charging them with, *inter alia,* conspiracy, wire fraud, and money laundering. The transactions at issue in the case at bar were a key part of the wire fraud charge for which Glantz was indicted.

The SEC now files this civil claim against Glantz and Block, claiming that unless enjoined, they will continue to engage in this behavior, participating in transactions which violate the anti-fraud provisions of the federal securities laws. Glantz answered the complaint, denying the SEC's allegations. Block did not file an answer, instead bringing this motion pursuant to Rule 12(b)(6), Fed.R.Civ.P., to dismiss the complaint against him.

II. DISCUSSION

The issue in a motion to dismiss under Rule 12(b)(6) is not whether the plaintiff will ultimately prevail, but whether the claimant is entitled to offer evidence supporting the claims. *Scheuer v. Rhodes,* 416 U.S. 232, 236 (1974). Accordingly, the trial court's function is to assess the legal sufficiency of the complaint, not to weigh the evidence which might be offered in support thereof. *Geisler v. Petrocelli,* 616 F.2d 636, 639 (2d Cir.1980); *Schieffelin & Co. v. Jack Co. of Boca, Inc.,* 725 F.Supp. 1314, 1322 (S.D.N.Y.1989). In making this assessment, the court must accept plaintiff's well-pleaded factual allegations as true, *Papasan v. Allain,* 478 U.S. 265, 283 (1986), and the allegations must be "construed favorably to the plaintiff." *LaBounty v. Adler,* 933 F.2d 121, 123 (2d Cir.1991). Rule 12(b)(6) motions are generally looked upon with disfavor, *Arfons v. E.I. Du Pont de Nemours & Co.,* 261 F.2d 434 (2d Cir.1958); 5A Wright & Miller, *Federal Practice & Procedure:* Civil 2d § 1357, at 321 (1990), and the court may not dismiss a complaint unless it is "clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King & Spalding,* 467 U.S. 69, 73 (1984) (citing *Conley v. Gibson,* 355 U.S. 41, 45–46 (1957)).

***3** Rule 8(a)(2), Fed.R.Civ.P., sets forth the requirements for pleading a claim in federal court, calling for "a short and plain statement of the claim showing that the pleader is entitled to relief." Rule 9(b), an exception to the generally liberal scope of pleadings, also applies to the case at bar. This rule states that "[i]n all averments of fraud ... the circumstances constituting fraud ... shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." The primary purpose of this rule is to provide defendant with fair notice of plaintiff's claim and the factual ground upon which it is based, as well as to protect defendant's reputation from improvident charges of wrongdoing. *Ross v. Bolton,* 904 F.2d 819 (2d Cir.1990). To satisfy Rule 9(b), a complaint of fraud "must adequately specify the statements it claims were false or misleading, give particulars as to the respect in which plaintiff contends the statements were fraudulent, state when and where the statements were made, and identify those responsible for the statements." *Cosmas v. Hassett,* 886 F.2d 8 (2d Cir.1989). *See also Luce v. Edelstein,* 802 F.2d 49, 54–55 (2d Cir.1986); *Goldman v. Belden,* 754 F.2d 1059, 1069 (2d Cir.1985). I find that the SEC's complaint meets the standards of both Rule 8(a) and 9(b) for each of its claims for relief.

A. Section 10(b) Claim

Section 10(b) of the Exchange Act, 15 U.S.C. § 78(j)(b), makes it unlawful to "use or employ ... any manipulative or deceptive device or contrivance" in connection with the purchase or sale of any security. In order to state a claim under Section 10(b), a plaintiff must allege "material misstatements or omissions indicating an intent to deceive or defraud in connection with the purchase or sale of a security." *McMahan & Co. v. Wherehouse Entertainment Inc.,* 900 F.2d 576, 581 (2d Cir.1990), *cert. denied,* 501 U.S. 1249 (1991) (citing *Luce v. Edelstein,* 802 F.2d 49, 55 (2d Cir.1986)). *See also Morin v. Trupin,* 778 F.Supp. 711, 717 (S.D.N.Y.1991); *LaRoe v. Elms Securities Corp.,* 700 F.Supp. 688, 693 (S.D.N.Y.1988).

The facts set forth in the SEC's complaint fulfill these requirements. Plaintiff claims that both Glantz and Block acted knowingly or recklessly as a part of a fraudulent scheme and misrepresented several material aspects of the proposed investment plan to both Cantwell and Bradley. Specifically, plaintiff alleges that Block performed the following misrepresentations: telling Cantwell that Swiss Bank agreed to extend a line of credit, stating that the investment was safe, promising payment of interest, and omitting the fact that the PBNs, ZICIs, and ZLOCs were fictitious instruments that could not be bought or sold. Complaint, ¶¶ 67–71.

As stated in *Luce v. Edelstein,* 802 F.2d 49, 56 (2d Cir.1986), "Plausible allegations that the defendants made specific promises to induce a securities transaction while secretly intending not to carry them out or knowing they could not be carried out, and that they were not carried are sufficient ... to state a claim for relief under Section 10(b)." The court qualified that statement, however, by saying "that failure does not constitute fraud if the promise was made with a good faith expectation that it would be carried out." *Id.* This reflects the holding of *Aaron v. SEC,* 446 U.S. 680, 695 (1980), which stated that "scienter is a necessary element of a violation of § 10(b)." [FN1] Although Rule 9(b) allows for general averments of scienter,

> ***4** [t]his does not mean ... that plaintiffs are relieved of their burden of pleading circumstances that provide at least a minimal factual basis for their conclusory allegations of scienter. 'It is reasonable to require that the plaintiffs specific-

ally plead those events' which 'give rise to a strong inference' that the defendants had an intent to defraud, knowledge of the falsity, or a reckless disregard for the truth.

Connecticut National Bank v. Fluor Corp., 808 F.2d 957, 962 (2d Cir.1987) (quoting *Ross v. A.H. Robbins Co.,* 607 F.2d 545, 558 (2d Cir.1979), *cert. denied* 446 U.S. 946 (1980)).

The SEC's complaint alleges scienter in a manner consistent with Fed.R.Civ.P. 9(b) by charging that "defendants Glantz and Block knew or were reckless in not knowing" of the fraudulent quality of their investment scheme. Complaint ¶ 69. It also provides facts which give rise to a strong inference that Block had the requisite fraudulent intent. The complaint alleges that after Block convinced Cantwell to invest funds, he manipulated the investment financing so that Cantwell's money did not go to Merrill Lynch as first promised, but instead to an account at Swiss Bank over which Glantz' company had power of attorney, to Bank Julius Baer, then finally to the account of Penrose, Block's company, at Barclays Bank in the Bahamas. From this, one could certainly infer that Block purposely acted in such a manner so as to gain personal control over Cantwell's money. Furthermore, the complaint alleges that in late 1992 Block persuaded Bradley to invest in a similar manner. By this time Block knew that Cantwell was not receiving interest payments as promised and knew or should have known that the PBNs, ZICIs and ZLOCs were not marketable. Thus, the complaint properly alleges that Block knew, or was reckless in not knowing, that he made misleading statements to Cantwell and Bradley in furtherance of a fraudulent scheme.

Although the complaint does properly allege scienter, Block challenges the assertions. His argument revolves around the indictment that was filed against Glantz in the District of Massachusetts. Block claims that the allegations contained in the indictment make it seem as though Glantz was the principal actor in the fraudulent scheme and Block was just an unwitting aide deceived by Glantz. Because of this, Block argues that the SEC is bound by the allegations, or lack thereof, contained in the indictment and that they can neither allege nor prove the requisite scienter against him now.

Block cites no authority for the novel theory that the SEC should be precluded from filing a civil complaint simply because the U.S. Attorney's office failed to obtain an indictment against him. It is true that a court may take judicial notice of prior proceedings in the evidentiary phase of trial. *See Deshmukh v. Cook,* 630 F.Supp. 956, 960 (S.D.N.Y.1986) ("[A] court can take judicial notice of the decisions in other proceedings ..."); 9 Wright & Miller, *Federal Practice & Procedure:* Civil 2d § 2410, at 582–84. However, there is no authority for the proposition that a litigant may use a prosecutor's failure to seek or obtain a criminal indictment against him in order to invoke a type of 'negative estoppel' during the pleading stage of a civil suit. I refuse to do so here, as I am of the opinion that the truth or falsity of the facts alleged in this complaint are best determined at trial. FN2

B. Section 17(a)(1) Claim

***5** Section 17(a)(1) of the Securities Act, 15 U.S.C. § 77q(a)(1), makes it unlawful to "employ any device, scheme, or artifice to defraud" in the offer or sale of any securities. The requirements to state a claim under Section 17(a)(1) are the same as those under Section 10(b), discussed above. *Morgan Stanley & Co. v. Archer Daniels Midland Co.,* 570 F.Supp. 1529, 1536 (S.D.N.Y.1983). For the reasons discussed above, then, I find that in paragraphs 58–62 of the complaint, plaintiff has properly stated a claim under this Section in accordance with Fed.R.Civ.P. 8(a) and 9(b).

C. Section 17(a)(2) Claim

Section 17(a)(2) of the Securities Act, 15 U.S.C. § 77q(a)(2), makes it unlawful "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 ... not misleading." The necessary elements to state a claim under Section 17(a)(2) are similar to those necessary for Section 10(b), *Morgan Stanley & Co. v. Archer Daniels Midland Co.,* 570 F.Supp. at 1536, but they differ in two ways: (i) under Section 17(a)(2), allegations and proof of scienter are not required, *Aaron v. SEC,* 446 U.S. at 697; and (ii) plaintiff must allege that defendant actually obtained money or property by means of the untrue statements.

Block claims that plaintiff has not adequately stated a claim under this Section because the SEC does not allege that he profited from the allegedly fraudulent scheme. In making this argument, Block misstates the legal requirements for a Section 17(a)(2) claim. The plain language of the statute specifically imposes liability on all those who “obtain money or property” through fraud, not only on those who “profit” from such activity. The SEC properly alleges that Block “obtained money or property” through his misconduct. Complaint ¶ 64(a).

The complaint also alleges facts in support of this contention. Specifically, it is alleged that Block induced Cantwell to deposit money into an account at Swiss Bank, over which CCMI had power of attorney, then directed it to the account of Penrose, Block's company, in the Bahamas. The SEC also alleges that Block induced Bradley to part with Cardinal's money, transferring part to Severn's account in the Bahamas and part to CCMI's Citibank account. Approximately $400,000 of this investment was allegedly used by Glantz for personal purposes. Complaint ¶¶ 39–52. These facts, if true, support the theory that Glantz and Block obtained money fraudulently by inducing Cantwell and Bradley to part with $1 million each and manipulating the situation until the money ended up within the defendants' control; this is sufficient to state a claim under Section 17(a)(2).

D. Section 17(a)(3) Claim

Section 17(a)(3) of the Securities Act, 15 U.S.C. § 77q(a)(1), makes it unlawful “to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.” To properly state a claim under Section 17(a)(3), the necessary elements are the same as those for Section 10(b) and 17(a)(1), although plaintiff need not allege or prove scienter. *See Morgan Stanley & Co. v. Archer Daniels Midland Co.,* 570 F.Supp. at 1536; *Aaron v. SEC,* 446 U.S. at 697. Therefore, for the same reasons as discussed for the Section 10(b) and 17(a)(1) claims, I find that plaintiff has properly stated a claim for relief under Section 17(a)(3). *See* Complaint ¶¶ 63–66.

***6** If proven, the facts set forth in the complaint would demonstrate that defendants violated Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act and Section 10(b) the Exchange Act. Moreover, the facts allegedly constituting fraud in this case are pled with sufficient particularity. The complaint is more than sufficient to put Block on notice of the claims against him, and it leaves no question of what fraud is alleged or the bases upon which the claims rest. Accordingly, I deny Block's motion to dismiss for failure to state a claim.

Counsel for all parties are directed to attend a status conference in Room 17C on October 27, 1995 at 3:00 p.m.

It is SO ORDERED.

FN1. In this Circuit, reckless conduct satisfies the scienter requirement for securities fraud. *Rolf v. Blyth, Eastman Dillon & Co., Inc.,* 570 F.2d 38, 46 (2d Cir.1978).

FN2. Block also relies on the indictment to support two further arguments. First, he argues that he was misled by Glantz and acted innocently. Block also claims that because he acted innocently, the SEC cannot prove a reasonable likelihood of recurrence of the violations, a necessary element in establishing the right to injunctive relief. Without addressing the merits of Block's defenses, it is clear that these factual contentions do not address the legal adequacy of the Complaint.

S.D.N.Y.,1995.
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Not Reported in F.Supp., 1995 WL 562180 (S.D.N.Y.), Fed. Sec. L. Rep. P 98,904

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