UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

LEONARD SOKOLOW, Individually and on Behalf of All Others Similarly Situated, Plaintiff, vs. LJM FUNDS MANAGEMENT, LTD., et al., Defendants.	)	No. 1:18-cv-01039 <u>CLASS ACTION</u> Hon. Judge Robert M. Dow, Jr.

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' JOINT MOTION TO DISMISS THE CONSOLIDATED COMPLAINT

TABLE OF CONTENTS

Page

Page

TABLE OF AUTHORITIES

Page

CASES

Page

Page

Page

Page

Page

STATUTES, RULES AND REGULATIONS

Plaintiffs[1] submit this memorandum of law in opposition to Defendants' Joint Motion to Dismiss the Consolidated Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) (ECF No. 150) and the memorandum of law filed in support thereof (ECF No. 151) ("Defs.' Br.").

INTRODUCTION

Defendants marketed a conservative investment in a mutual fund that would "preserve" capital and employ "sophisticated risk management." They even called it a "Preservation Fund." In reality, and unbeknownst to investors, Defendants pursued an incredibly aggressive strategy of making unmitigated and highly leveraged options trades, with essentially no risk management controls. As a result, investors were misled by the Defendants' statements and suffered a near total loss of their investments as 80% of the Fund's value, more than $600 million, evaporated in just two days on a modest market decline. Defendants seek early dismissal of the – strict liability – claims by raising six meritless arguments.

First, Defendants attempt to raise the bar for pleading by adding scienter as an element of the non-fraud claims and arguing Defendants' alternative interpretations to the factual allegations and materials attached to their brief. Defs.' Br. at 2, 16-19. But scienter is not an element of the §§11 and 12 claims, and Defendants' attempt to dispute the facts alleged is inappropriate on a motion to dismiss. Because the factual allegations – accepted as true – adequately pleads that statements about the Fund's objectives, risk controls, and past performance were false and misleading, dismissal is appropriate.

Second, Defendants suggest that purported warnings sprinkled throughout the Offering Materials wholly offset the alleged false and misleading statements. The sufficiency of risk

[1] Unless otherwise indicated, capitalized terms herein have the definitions ascribed to them in the Consolidated Complaint for Violations of the Federal Securities Laws (ECF No. 114) ("Complaint"). Citations to the Complaint are designated as ("¶¶"). Internal citations are omitted and emphasis added, unless otherwise noted.

warnings and how they would be interpreted by a reasonable investor is a highly factual issue that is generally inappropriate for a motion to dismiss. In any event, the risk warnings were boilerplate and misleading. According to Defendants, warnings that particular investments, like "derivatives held by the Fund" or "written put transaction[s]" (Defs.' Br. at 3), could result in large or potentially unlimited losses for *those transactions or investments*, were somehow sufficient to warn investors that 80% of the *entire* Preservation Fund could be wiped out in two days. However, these generic and common sense warnings that a particular trade accounting for an unspecified portion of the Fund could result in a loss were themselves misleading, and did not offset the Fund's stated objectives of "capital preservation" and overall "Preservation Fund" strategies.

Third, Defendants attempt to argue a lack of loss causation, but under §§11 and 12 it is Defendants' burden to prove negative loss causation as an affirmative defense, which they simply cannot do at the pleading stage. The single case Defendants rely upon, *In re State Street Bank and Tr. Co. Fixed Income Funds Inv. Litig.*, 774 F. Supp. 2d 584, 588 (S.D.N.Y. 2011) ("*State Street*"), is an outlier opinion that has been soundly rejected by other courts in the same district and throughout the country, which recognize that cutting off mutual fund investors from the protections of the Securities Act of 1933 (the "1933 Act") would lead to the absurd result that mutual fund companies could lie with impunity. *See, e.g.*, *In re Oppenheimer Rochester Funds Grp. Sec. Litig.*, 838 F. Supp. 2d 1148, 1176 (D. Colo. 2012). Notably, Defendants cite to no case decided after *State Street* that adopts this approach.

Fourth, Defendants try to claim the Individual Defendants and the Underwriter were not statutory sellers for purposes of §12. The Complaint, however, sufficiently alleges that these Defendants were statutory sellers in that they, among other things, signed the Registration Statements or served as the underwriter to the offerings, which courts have routinely held is sufficient. Moreover, the Complaint and Offering Materials make clear that both the Trustee Defendants and the Underwriter were actively involved in soliciting investors for the Fund.

Fifth, the Individual Defendants and the Underwriter claim they did not actually exercise control over other Defendants. But the well-pled facts meet the low burden for alleging control, and, again, Defendants' arguments attempt to raise fact disputes inappropriate for a motion to dismiss.

Sixth, and finally, Defendants raise a half-hearted – and fact-intensive – statute of limitations argument that has no merit. At no point prior to the Fund's collapse were investors apprised that the Fund was overexposed to unmitigated and highly leveraged trades with no adequate risk mitigation techniques in place such that their entire investments were at risk of being wiped out at a moment's notice.

Thus, Defendants' motion to dismiss these strict liability claims should be denied in its entirety.

FACTUAL BACKGROUND

A. The Preservation Fund, Investment Objectives, and Strategies

Defendants offered and sold shares of the Preservation Fund based on its supposed low-risk and conservative approach. Indeed, the Fund's registration statements, shareholder reports, prospectuses, facts sheets, and brochures (Offering Materials) issued between February 28, 2015 and February 7, 2018 (the "Class Period"), claimed the primary investment objective of the Fund was "*capital appreciation and capital preservation*." ¶¶52, 53(a). Investors who wanted to buy into Defendants' more aggressive strategies – and knowingly accept the increased risks of doing so – could have invested in LJM's "Moderately Aggressive" or "Aggressive" funds. However, the Offering Materials assured investors that, as its name suggests, the Preservation Fund sought lower risk and moderate growth through a conservative strategy that would preserve capital and employ risk mitigation techniques to avoid the massive risks of aggressive hedge funds seeking greater returns. ¶¶53-54. These statements enticed investors, and the Preservation Fund attracted hundreds of millions of dollars from investors. ¶48.

During the Class Period, Defendants operated the Preservation Fund as an open-ended mutual fund pursuant to the Investment Company Act of 1940 (the "1940 Act"). ¶17. Issuers and sellers of mutual funds under the 1940 Act must comply with the disclosure requirements of the 1933 Act to market and sell securities to the public. 15 U.S.C. §77j. Defendants marketed the Fund to retail investors as a low-risk, capital preservation fund, which utilized a high level of risk mitigating hedge transactions. ¶36. Its strategy was premised on the idea that options buyers overestimate the probability of high-volatility events and therefore implied volatility outpaces actual volatility, creating what is known as the "volatility premium." ¶42. Defendants thus purported to engage in an investment strategy that profited off the volatility premium through strategies and complex options that become more profitable if the market became less volatile than anticipated by the trading public. ¶¶36, 42. The Fund was further marketed as having minimal correlation to the U.S. equity market, which meant that a downturn in the equity markets was not expected to cause a significant and sustained downturn in the Preservation Fund. ¶36.

According to the Fund's Offering Materials, the Fund sought to meet its stated objectives by "capturing gains on options sold on S&P futures contracts that can be purchased ('closed') at a later date for a lower price than the price realized when originally sold." ¶47. Its Offering Materials emphasized that the Fund sought "*capital appreciation and capital preservation with low correlation to the broader U.S. equity market*" and that it aimed "*to preserve capital, particularly in down markets (including major market drawdowns), through using put option spreads as a form of mitigation risk*." ¶¶53(a)-(b).

To supposedly protect investors from significant loss, and to meet the Fund's objectives, the Offering Materials assured investors that the Fund had employed "*various risk mitigation techniques*

. . . *in order to generate returns regardless of market direction*." ¶53(b). They further noted that the Fund was able to effectively mitigate risk through its "*techniques . . . that have historically provided for the recovery of losses within a reasonable time frame*." *Id.* In other words, while the Fund's strategy would "bet" against volatility, Defendants assured the market that the Fund would not bet everything and would always have enough mitigation investments on to not place the entire investment at risk. ¶4. Based on these representations, the Fund became known as "one of the hottest trades in the financial markets," and in 2017 alone was flooded with approximately $400 million in investments. ¶48.

B. The Preservation Fund's Overexposure to the Risk of Volatility

In reality – and unbeknownst to investors – Defendants routinely made massive and unmitigated bets that exposed investors to excessive risks and catastrophic losses of capital. ¶¶50, 54. The Fund was overexposed to the risk of volatility through leveraged options and had no investment or market position to adequately preserve capital and mitigate risk in the face of volatility. ¶54. Because the Fund faced the likely risk of unlimited loss of capital in even a moderately down market, the Fund was not the conservative investment portrayed to investors in the Offering Materials. ¶¶33, 50.

C. The Fund Collapsed in February 2018 Due to Its Risky Trading Positions

These concealed risks materialized in February 2018, when the Fund experienced one of the most rapid mutual fund collapses in history. ¶61. Because the Fund's risky trading practices were contrary to its stated objective and investment strategies, following a modest downturn in equity markets of less than 5%, the Fund lost a staggering *80%* of its net asset value ("NAV") *over the course of two days*, resulting in *more than $600 million* in investor losses. ¶¶49, 58. Moreover, despite the Registration Statements' representations that the NAV "is determined at 4:00 p.m.

(Eastern Time) on each day the [NYSE] is open for business," the Fund did not post its NAV the first day, leaving investors in the dark as to the initial decline and unable to exit the Fund to mitigate their losses. ¶59. The massive losses made clear that, contrary to the stated conservative objectives and risk disclosures, the Fund had no investment or market position to adequately preserve capital and mitigate risk in the face of volatility. ¶54.

In particular, on Monday, February 5, 2018, the Dow fell approximately 4.6%, the S&P 500 fell 4.1%, yet the Preservation Fund fell 56% with the NAV for the Fund's shares falling from $9.67 per share to $4.27 per share. ¶58. The next day, the Dow and S&P 500 increased by approximately 2% but the Preservation Fund fell again, this time to $1.91 per share, a total cumulative loss of 80% of the Fund's value. *Id.* Such a rapid deterioration in NAV was extremely unusual, especially given the representations regarding the Fund's conservatism and risk controls. News reports at the time characterized the loss as "jaw-droppingly awful," a "collapse," a "debacle," the "biggest one-week drop for a mutual fund recorded in 20 years," and perhaps "the biggest two-day drop for a mutual fund ever." ¶61.

D. Analyst Reaction Confirms the Preservation Fund Was Misrepresented

Other funds with similar trading strategies did not collapse from the spike in volatility, which left analysts and investors perplexed as to how such a large loss was possible, particular for a "Preservation" Fund. For example, market commentator *Morningstar* reported that the Fund had made bets exposing it to "extraordinary risks," including selling "naked put options on S&P futures" that caused the Fund to be "leveraged and [with] above-average margin [borrowing] levels," and described the Fund as "unique in that it failed to employ proper risk controls." ¶¶62, 64. Tellingly, *Morningstar* noted that "[t]his fund *should never have been marketed to fund shareholders as a tool for capital preservation*." ¶62. Another media outlet commented that while other "exchange-traded products" also suffered losses on the volatility increase, the difference between those and the Preservation Fund is that "they are expressly designed for experienced short-term speculators, not long-term investors, and their objective of shorting volatility is in their name. Also, those [products] are priced and tradable throughout the day, enabling an exit for distressed investors during a slide." ¶64. Subsequently, *Morningstar* downgraded the Fund to "[n]egative, not only because of the loss in fund holder value, but also because of the lack of oversight on the part of the fund company, not to strike a NAV the following day." ¶67. The analyst further commented that this was "a *complete failure* on the part of [the Fund's] risk management process." *Id.*

In the weeks that followed, analysts continued to express their astonishment. On February 14, 2018, an analyst noted that the Fund had been "taking a tremendous amount of risk" and described its collapse as "kind of shocking for really just a modest downturn, and a modest spike in volatility." ¶68. In March, *Morningstar* explained that the Fund "employed a short-volatility strategy that sold put-options on S&P 500 futures without owning the underlying security, which left it vulnerable to a margin call during a period of volatility." *Id. Morningstar* added, "[t]he[] [Fund's] disastrous losses, poor management, and absent fund holder communication are big red flags. Although the fund's high 2.24% expense ratio had deterred many investors, those who did invest incurred a permanent loss of capital." *Id.*

On February 27, 2018, Defendants LJM and the Trust announced in an SEC filing that they had decided to liquate and dissolve the Preservation Fund, which was set to close on March 29, 2018. ¶69. Fund investors were left with massive losses and had no choice but to redeem only a small fraction of their investment. *Id.*

ARGUMENT

I. LEGAL STANDARDS FOR A MOTION TO DISMISS 1933 ACT CLAIMS UNDER RULE 8

Defendants seek to raise the bar for pleading Plaintiffs' strict liability claims, but unlike securities fraud claims, claims under §§11, 12, and 15 of the 1933 Act are subject to Rule 8(a) of the Federal Rules of Civil Procedure ("Rule"). *See In re Groupon, Inc. Sec. Litig.*, No. 12 CV 2450, 2013 WL 12284524, at *1, *3 (N.D. Ill. Sept. 18, 2013) (holding that "the heightened pleading standard of Rule 9 does not apply" to Sections 11, 12, and 15 claims and finding plaintiffs had adequately pled their claims "[f]or purposes of the notice pleading under Rule 8"). To plead a claim under Rule 8(a), a plaintiff need only provide a "short and plain statement of the claim" containing sufficient factual matter, accepted as true, to state a plausible claim for relief. Fed. R. Civ. P. 8(a)(2); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555-56 (2007).

In determining whether the complaint alleges false and misleading statements, the Court need not rule upon each individual statement in order to deny the motion to dismiss, so long as at least one false or misleading statement is adequately alleged. *See e.g.*, *Ross v. Career Educ. Corp.*, No. 12 C 276, 2012 WL 5363431, *8 (N.D. Ill. Oct. 30, 2012) (denying motion and holding "because plaintiffs have, by the allegations already discussed, met their burden of alleging [a false or misleading statement], the Court need not address the [additional] statements in the third category").

II. THE COMPLAINT ADEQUATELY ALLEGES FALSE AND MISLEADING STATEMENTS

To establish a claim for violations of §§11 and 12(a)(2), plaintiffs "need only show that they purchased the security and that there was a material misrepresentation or omission." *In re Ulta Salon, Cosmetics & Fragrance, Inc. Sec. Litig.*, 604 F. Supp. 2d 1188, 1192 (N.D. Ill. 2009). Liability of the issuer of a materially misleading registration statement or prospectus is "virtually absolute, even for innocent misstatements." *Id.* Indeed, the 1933 Act was passed to impose "a stringent standard of liability on the parties who play a direct role in a registered offering," and "reflects Congress' sense that underwriters, issuers, and accountants bear a 'moral responsibility to the public [that] is particularly heavy.'" *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 657 (S.D.N.Y. 2004).

A. Defendants' Factual Disputes and Arguments Regarding the Interpretation of the Statements Are Inappropriate for a Motion to Dismiss

The Complaint sufficiently alleges that the statements regarding the Preservation Fund's objectives, risk controls, and past performance were false and misleading. As a threshold matter, Defendants' arguments boil down to factual disputes about what trades led to the Fund's collapse and how Defendants interpret the alleged misstatements in the Offering Materials. Defs.' Br. at 10-15. But these arguments are inappropriate for a motion to dismiss because "[i]t is not the function of th[e] Court at the pleading stage to determine whether the statements were in fact false or misleading." *City of Lakeland Emps. Pension Plan v. Baxter Int'l Inc.*, No. 10 C 6016, 2012 WL 607578, at *2 (N.D. Ill. Jan. 23, 2012).

To plead a false statement, a plaintiff is not required to "prove the truth of his allegations." *Jones v. Corus Bankshares, Inc.*, 701 F. Supp. 2d 1014, 1021 (N.D. Ill. 2010). Rather, the "relevant question is 'whether the facts alleged are sufficient to support a reasonable belief as to the misleading nature of the statement or omission.'" *ABN Amro, Inc. v. Capital Int'l Ltd.*, 595 F. Supp. 2d 805, 835 (N.D. Ill. 2008) (Dow, J.) (quoting *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 437 F.3d 588, 595 (7th Cir. 2006), *rev'd on other grounds*, 551 U.S. 308 (2007)). Only where the statements at issue are clearly neither false nor misleading should courts grant dismissal. *See, e.g.*, *In re Spiegel, Inc. Sec. Litig.*, 382 F. Supp. 2d 989, 1028 (N.D. Ill. 2004) (denying motion to dismiss because whether statements were false was "a mixed question of law and fact" requiring "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts").

Thus, Defendants' factual disputes regarding the particular trades that caused the Fund's collapse and arguments over investors should have interpreted the Offering Materials fail to establish that the challenged statements were truthful as a matter of law, and their motion should be denied.

B. Each of the Challenged Statements Were False and Misleading

Whether a statement is misleading depends on the perspective of a reasonable investor. *See Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, _U.S._, 135 S. Ct. 1318, 1327 (2015). Considering the false or misleading statements in the full context in which they were made is critical because "statements, even if literally true, could still be misleading to investors depending on the context and manner of their presentation." *Ross*, 2012 WL 5363431, at *6; *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Tr. Fund v. Allscripts-Misys Healthcare Sols., Inc.*, 778 F. Supp. 2d 858, 878 (N.D. Ill. 2011) (same). Literally true statements can form the basis of liability because "a statement that contains only favorable matters and omits all reference to unfavorable matters is as much a false representation as if all the facts stated were untrue." *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 240 (2d Cir. 2016).

1. The Statements Regarding the Preservation Fund's Objectives Were Materially False and Misleading

Here, the Preservation Fund's stated objective of "capital appreciation and capital preservation with low correlation to the broader U.S. equity market" was false and misleading because Defendants engaged in speculative and aggressive trading that exposed the entire investment to being wiped out from what analysts described as a "modest" spike in volatility. ¶¶53(a), 68.[2] The

[2] Defendants' brief begins with a litany of facts that lack any supporting citation to the Complaint, several of which are in dispute. Defs.' Br. at 1-5. However, all new facts that are unsupported by citation or that conflict with the allegations in the Complaint must be stricken and disregarded on a motion to dismiss. *See* Fed. R. Civ. P. 12(d); *City of Sterling Heights Gen. Emps.' Ret. Sys. v. Hospira, Inc.*, No. 11 C 8332, 2013 WL 566805, at *10 (N.D. Ill. Feb. 13, 2013) (citing *Tierney v. Vahle*, 304 F.3d 734, 738-39 (7th Cir. 2002)) ("[I]n deciding a motion to dismiss, courts look only to matters within the four corners of the complaint.").

Offering Materials contain several other false and misleading statements in this category that unequivocally represented that the Fund had adopted a trading strategy that was designed to protect its investors against precisely the type of loss that occurred here (*see, e.g.*, ¶53(b)), "*[t]he Fund aims to preserve capital, particularly in down markets (including major market drawdowns), through using put option spreads as a form of mitigation risk*"); ¶53(i) (representing that the Fund's strategies "*aim to contain risk during extreme events to create a positive, uncorrelated stream of returns over the long term*"). The Complaint alleges that Defendants' high-risk investment strategy, which exposed investors to catastrophic losses in the Fund's value, was completely at odds with the Fund's stated objectives and investment strategies. *See, e.g.*, ¶62 (Citing analyst reports that the Fund had made bets exposing it to "extraordinary risks" that included selling "naked put options on S&P 500 futures," writing, "[t]his fund should never have been marketed to fund shareholders as a tool for capital preservation").

The case most analogous on all the issues raised in this motion is *Oppenheimer*, 838 F. Supp. 2d 1148. There, the Court denied a motion to dismiss §§11 and 12 claims where, as here, plaintiffs alleged that defendants employed a highly leveraged investment strategy that was at odds with defendants' "capital preservation pitch" because it was "an essential feature of the [f]unds that reasonable investors would consider important." *Id.* at 1164-65. The Court in *Oppenheimer* reasoned that if, as here, "[d]efendants' stated investment strategies were materially different from the strategies actually pursued, or that the risks of the investment strategy were materially misleading given the actual and foreseeable risks posed, then [d]efendants' stated investment objectives cannot be said to have been 'immaterial' or 'not misleading' to a reasonable investor as a matter of law." *Id.* at 1162-63; *see also In re Evergreen Ultra Short Opportunities Fund Sec. Litig.*, 705 F. Supp. 2d 86, 92 (D. Mass. 2010) (holding that stated objectives of "preservation of capital and low principal fluctuation" were actionable when combined with other statements regarding the fund's investment strategies because such statements were "key guidelines that established the [t]rust's investment strategy" and "in all likelihood, of utmost importance to potential investors"). Thus, the Fund's stated objectives were false and misleading.

Contrary to Defendants' arguments, Plaintiffs do not criticize Defendants for having an overly optimistic goal or inadequate estimate of future costs. Rather, Plaintiffs allege that the Fund's trading practices and failure to employ risk mitigation techniques were fundamentally at odds with the Fund's stated objective of capital preservation and low market correlation. Unlike the fraud by hindsight cases Defendants rely upon, the contradiction between the stated objectives of the Fund and its high-risk trading practices were clearly knowable by Defendants at the time the statements were made. *See Castlerock Mgmt., Ltd. v. Ultralife Batteries, Inc.*, 114 F. Supp. 2d 316, 322-23 (D.N.J. 2000) (dismissing case because plaintiff did not allege the production problems "were actually known or knowable" when the statements were made); *In re ProShares Tr. Secs. Litig.*, 889 F. Supp. 2d 644, 656 (S.D.N.Y. 2012) (dismissing claim where plaintiffs' own allegations admitted that the falsity of alleged misstatements depended on market-data inputs that could not be known in advance), *aff'd*, 728 F.3d 96 (2d Cir. 2013).[3]

Defendants' suggestion that Plaintiffs must show they did not *intend* to follow the stated objectives of the Fund is a meritless attempt to require proof of scienter. Defs.' Br. at 9. Defendants rely upon distinguishable cases that involve vague aspirational goals or best estimates of accounting matters. *See, e.g.*, *Eckstein v. Balcor Film Inv'rs*, 8 F.3d 1121, 1132 (7th Cir. 1993) (addressing statements that defendants told the investors that it hoped, even "expected," that New World's films

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[3] Defendants' other cases also involve puffery and vague aspirational statements, but do not hold that statements regarding a fund's investment strategy cannot form the basis of a claim. *See, e.g.*, *Scott v. Gen. Motors Co.*, 605 F. App'x 52, 54 (2d Cir. 2015) (statements of profitability goals were generic "expression[s] of mere corporate optimism"); *In re Xinhua Fin. Media, Ltd. Sec. Litig.*, No. 07 Civ. 3994 (LTS)(AJP), 2009 WL 464934, at *8 (S.D.N.Y. Feb. 25, 2009) (adjectives such as "strong," "experienced," and "capable" were mere puffery); *Sequel Capital, LLC v. Rothman*, No. 03 C 0678, 2003 WL 22757758, at *12 (N.D. Ill. Nov. 20, 2003) (statements that the company had an "unparalleled management team" were not actionable).

would be commercial successes); *City of New Orleans Emps.' Ret. Sys. v. PrivateBankcorp, Inc.*, No. 10 C 6826, 2011 WL 5374095, at *10 (N.D. Ill. Nov. 3, 2011) (holding "adequacy of loan loss reserves can only be actionable . . . if it is alleged that defendants did not actually believe that loan loss reserves were adequate and defendants had no reasonable factual basis for that belief"). Here, Plaintiffs have not alleged Defendants their beliefs about the success of the Fund. Plaintiffs' allege Defendants misrepresented the Fund's strategy as it was materially different (*i.e.*, riskier and far more aggressive) than what Defendants told their investors.

2. Statements Regarding the Fund's Risk Controls Were Materially False and Misleading

Defendants' representations that the Fund employed adequate risk mitigation techniques were also materially false and misleading. ¶¶36, 47, 53. Defendants repeatedly emphasized the Fund's risk mitigation strategies, noting that it employed "*sophisticated risk management to balance the amount of risk that [it is] willing to carry*," and "*various risk mitigation techniques . . . in order to generate returns regardless of market direction*," including the "*strategic use of hedging*" and the purchase of "*options to help mitigate the impact of sudden price moves*." ¶¶53(b), (f), (i).[4]

Contrary to these representations, however, the Fund lacked adequate risk controls and oversight to protect against overly aggressive and unprotected trading positions. ¶54. Instead, it was aggressively overexposed to down markets and spikes in volatility as reflected by the fact that the modest S&P 500 drop of roughly 2% over two days resulted in the Fund losing 80% of its value. *Id.* Defendants' purported "sophisticated risk management" and "strategic use of hedging" represented

[4] The remaining misrepresentations in this category include Defendants' statements that the Fund was "*constantly improving risk management and evolving to manage an ever-growing number of market scenarios,*" that the Fund's strategies "*aim to contain risk during extreme events to create a positive, uncorrelated stream of returns over the long term*," and that the Fund provided its investors opportunities "*to improve risk-adjusted returns through exposure to well-managed alternative strategies*" which "*emphasize proper risk management and seek to provide positive returns with low correlation to the broader U.S. equity markets*" ¶¶53(e), (i).

to investors that the Fund could actively mitigate the risks presented from its investment strategy when, in truth, it simply could not avoid such risks due to its failure to implement adequate risk controls. *See* ¶¶53(f), (i), 54; *Gosselin v. First Tr. Advisors L.P.*, No. 08 C 5213, 2009 WL 5064295, at *1, *3 (N.D. Ill. Dec. 17, 2009) (holding that allegations that defendants falsely represented "they had sufficient internal controls in place to monitor and manage the risks of the [f]unds' investments" were sufficiently misleading such that "[p]laintiffs' case at the pleadings stage does not rest merely on the issue of whether [d]efendants mismanaged the [f]unds and used poor business judgment"); *Hunt v. All. N. Am. Gov't Income Tr., Inc.*, 159 F.3d 723, 729 (2d Cir. 1998) ("[t]hat the prospectuses disclosed the possible inefficacy of hedges does not shield the [f]und from liability for misrepresenting the availability of hedging opportunities").

Here, Plaintiffs allege that contrary to the statements in the Offering Materials, the Fund had no investment or market position to adequately preserve capital and mitigate risk in the face of temporary volatility. ¶6. Instead, the Fund was overly-invested in naked, unmitigated, and highly leveraged options trades, and lacked adequate risk controls to protect against these aggressive and unprotected trading positions. As a result, investors who were misled by the Fund's statements suffered a near total loss in their investments.

3. Statements Regarding Past Performance Were Materially False and Misleading

Defendants' emphasis in the Registration Statements on the Fund's past performance was also materially false and misleading. ¶¶53(d)-(f). While "accurate statements of historical fact" are not, by themselves, actionable, such statements may become actionable where the defendant "paint[s] a deceptive picture" by omitting material information. *In re Next Level Sys., Inc.*, No. 97 C 7362, 1999 WL 387446, at *6-*7 (N.D. Ill. Mar. 31, 1999).

Defendants represented to investors in the Offering Materials that the Fund had previously experienced periodic volatility and that on those occasions its "*techniques . . . [had] historically provided for the recovery of losses within a reasonable time frame*," including after "*the largest intraday spike in the history of available intraday data*" in which the Fund utilized its "*experience and risk management tools to control losses and position the portfolio for a quick recovery . . . over the next month*." ¶¶53(d)-(e).[5] These representations served to reinforce the false and misleading statements regarding the Fund's objectives and risk controls by assuring investors the Fund would employ strategies to withstand volatility, while concealing that the Fund was pursuing a much riskier strategy without risk mitigation. *See Friedman v. Rayovac Corp.*, 295 F. Supp. 2d 957, 991 (W.D. Wis. 2003) (holding that sales figures that were not literally false were nonetheless misleading and stating "it is well-established that a statement that is technically true can still be misleading").

Defendants rely upon distinguishable cases which do not involve false or misleading statements (Defs.' Br. at 18), so the boilerplate disclaimer that past performance could not guarantee future performance is irrelevant. *See Shankar v. Imperva, Inc.*, No. 14-cv-1680-PJH, 2016 WL 2851859, at *7 (N.D. Cal. May 16, 2016) (finding risk warning that "you should not rely on our past results as an indication of our future performance" was "overly vague" and therefore an insufficient basis to dismiss the complaint); *In re Enron Corp. Sec., Derivative and ERISA Litig.*, 235 F. Supp. 2d 549, 689-90 (S.D. Tex. 2002) (disclaimer that "past performance is not indicative of future results" was "vague, generic, [and] cursory" rather than a "meaningful cautionary statement[] identifying important factors that might cause material differences in actual results").

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[5] The rest of the misrepresentations in this category the Defendants' statements that "*[w]hen equity markets [have] experience[d] periodic volatility, the behavior was in line with scenarios that the LJM portfolio management team has experienced in the past and has incorporated into our risk models*"; that, in the past, "*[t]he higher implied volatility levels created additional opportunities to create favorable risk/reward profiles and ultimately profit*"; and that the Fund's "*strategic use of hedging and opportunistic options writing when implied volatility rose allowed our investment management team to navigate the two [volatility] whipsaws*." ¶¶53(e)-(f).

4. Defendants' Risk Warnings Were Inadequate

Defendants argue that the misleading nature of the challenged statements was offset by purported risk warnings in the Offering Materials. There are two reasons why this argument fails: (i) the risk disclosures did not adequately warn investors that the entire Fund could be wiped out and that the Fund's trading positions exposed investors to catastrophic loss; and (ii) the sufficiency of Defendants' risk disclosures is a fact intensive inquiry that can rarely be decided on a motion to dismiss.

a. The Risk Disclosures Failed to Warn of Catastrophic Losses

First, drawing all reasonable inferences in favor of Plaintiffs, the purported warnings Defendants rely upon at best warned investors that singular transactions or investments could result in large losses, not that the entire "Preservation Fund" could be put at risk through highly aggressive trading without risk controls. Defendants point to warnings of "large" or "unlimited" losses but ignore that those are in the context of particular "derivatives" or "transaction[s]." Defs.' Br. at 11. Such warnings regarding singular investments did not negate the false and misleading statements by which Defendants assured investors that the overall "Preservation Fund" was conservatively invested with positive returns that remained protected through extensive risk mitigation. For example, statements that leverage "can result in loss of an amount substantially greater than the amount invested in the derivative" did not disclose that the Fund was overexposed to unmitigated highly-leveraged trades, and statements that "losses are potentially large in a written put transaction" or "unlimited in a written call transaction," did not make clear that the entire Preservation Fund was at risk of catastrophic loss. *Id.*

Similarly, while the disclosures stated that there was a "possib[ility]" that losses "could" occur as a result of increased volatility, *id.*, Defendants failed to disclose that the Fund's high-risk investment strategy made large losses foreseeable and inevitable. Put differently, to the extent the Fund's risk disclosures could have made Plaintiffs aware of the risks of investing in a mutual fund marketed for capital preservation, they cannot be said to have adequately disclosed the risks of investing in a fund which employed the aggressive and high-risk strategies that were actually pursued by the Fund. *See, e.g.*, *Oppenheimer*, 838 F. Supp. 2d at 1162-63 (holding that multiple risk disclosures were not sufficiently "substantive," "tailored," and "prominent" to render the alleged misleading statements true or immaterial); *Pommer v. Medtest Corp.*, 961 F.2d 620, 624-25 (7th Cir. 1992) (because "[d]isclosures assist investors in determining the magnitude of risks," disclosing that a certain endeavor "may prove to be totally worthless" was insufficient as it "d[id] not enlighten investors about the status" of the current situation); *Shah v. Zimmer Biomet Holdings, Inc.*, 348 F. Supp. 3d 821, 841 (N.D. Ind. 2018) (denying motion to dismiss and holding cautionary language was not "substantive and tailored" to the statements made). Thus, the risk disclosures Defendants rely on were, as Plaintiffs allege, themselves misleading. ¶57.

In addition, many of the risk disclosures that Defendants rely upon (Defs.' Br. at 13), were buried in the Fund's Annual Reports from 2015 and 2016 and were not mentioned in the prospectus at all. *See Eckstein*, 8 F.3d at 1132 (allegations that "risk disclosures in the prospectus were buried or indigestible" would support the inadequacy of such disclosures); *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 453 n.11 (S.D.N.Y. 2005) ("An investor should not be called upon to piece together buried information from distinct parts of financial statements in order to understand basic aspects of a company's finances.").

b. The Sufficiency of the Fund's Risk Warnings Cannot be Decided on a Motion to Dismiss

Second, although this case does not involve forward-looking statements protected by the PSLRA safe harbor, Defendants' arguments fail for the same reason that courts find the sufficiency of cautionary language is fact-intensive and "not [a] question to be answered on a motion to dismiss." *Blatt v. Corn Prods. Int'l, Inc.*, No. 05 C 3033, 2006 WL 1697013, at *5 (N.D. Ill. June 14, 2006); *see also Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 729, 734 (7th Cir. 2004) (evaluating cautionary language "resists a concrete rendition and thus makes administration of the safe harbor difficult if not impossible" because there is "no reason that a court can accept at the pleading stage, before plaintiffs have access to discovery" that the warnings were sufficient).

Here, warnings that the value of the Fund could fluctuate or money could be lost were clearly insufficient to warn investors that the Fund objectives would not be pursued, the risk controls would not be utilized, and the entire Preservation Fund would be put at risk of a catastrophic loss from even a modest spike in volatility. *See e.g.*, *Tellabs*, 437 F.3d at 599 (holding with regard to risk warnings under the PSLRA safe harbor that the "breadth of the[] warnings makes it impossible for [the court] to conclude that they meaningfully describe 'the principal or important risks' facing [defendant] at the time it made the projections" and "this level of generality exemplifies the useless *caveat emptor* boilerplate [the court] criticized in *Asher*. . ."); *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 249 (5th Cir. 2009) ("the total mix of information was misleading, because it was highly skewed toward the promised benefits").

Defendants rely upon distinguishable cases where none of the statements were false or misleading. For example, in *Tabankin*, the court held that the much vaguer statement that the fund's objective was to provide "prudent investment management" was not materially false because the fund followed the described investment strategy and the risks were adequately disclosed. *Tabankin v. Kemper Short-Term Glob. Income Fund*, No. 93 C 5231, 1994 WL 30541, at *1, *4 (N.D. Ill. Feb. 1, 1994). In contrast, here, despite the Offering Materials' repeated emphasis on the Fund's conservative investment strategy and extensive risk mitigation focused on "preservation," the Fund did not follow its strategy of capital preservation, failed to employ the described risk mitigation techniques, and the warnings were clearly insufficient. *See Oppenheimer*, 838 F. Supp. 2d at 1155, 1176 (rejecting defendants' reliance on *Tabankin* and holding that statements about the fund's "preservation of capital" strategy were misleading where, as here, plaintiffs alleged the fund actually employed an "aggressive" and "high-risk" strategy that "placed investors' capital at tremendous and undisclosed risk").

5. Defendants Violated Items 303 and 503

In addition to the statements made, the Offering Materials were false and misleading because they omitted known trends or uncertainties in violation of Regulation S-K Items 303 and 503. ¶¶55-57. Specifically, Defendants failed to disclose that the Fund was overexposed to unmitigated and highly leveraged trades that would result in a complete loss in the event of a modest market downturn. *See id.* at ¶¶55-69. Defendants fail to adequately address, and therefore waive any challenge to, Plaintiffs' Items 303 and 503 allegations. *Id.* As the Seventh Circuit has made clear, undeveloped arguments, especially those made in a footnote, are waived. *See Harmon v. Gordon*, 712 F.3d 1044, 1053 (7th Cir. 2013) ("[A] party can waive an argument by presenting it only in an undeveloped footnote."). Defendants' "argument" as to Items 303 and 503 consists of one sentence in a footnote, and contains no citation to authority. Defs.' Br. at 13 n.7; *see Parker v. Franklin Cty. Cmty. Sch. Corp.*, 667 F.3d 910, 924 (7th Cir. 2012) (finding waiver because defendants' "argument is in a footnote, consists of four sentences, and contains no citation to authority").[6] Therefore, this argument is waived, and Plaintiffs have adequately pled violations of Items 303 and 503.

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[6] Defendants cannot develop this argument in their reply brief since arguments raised for the first time in a reply brief are waived. *See Broaddus v. Shields*, 665 F.3d 846, 854 (7th Cir. 2011) (rejecting argument that was not raised in opening brief and holding, "once again, we invoke our well established waiver jurisprudence: arguments raised for the first time in a reply brief are waived"), *overruled on other grounds by Hill v. Tangherlini*, 724 F.3d 965 (7th Cir. 2013).

III. DEFENDANTS HAVE NOT ESTABLISHED NEGATIVE LOSS CAUSATION

Defendants argue that the Complaint fails to allege loss causation, but it is well recognized that claims under Sections 11 and 12 do not require allegations of loss causation. *See Gosselin*, 2009 WL 5064295, at *7 (defendants must establish negative loss causation as "an affirmative defense"). For a defendant to sustain a negative loss causation affirmative defense, it must show that the plaintiff's "allegations clearly point to the existence of the defense." *Evergreen Fund, Ltd. v. McCoy*, No. 00 C 0767, 2000 WL 1693963, at *7 (N.D. Ill. Nov. 6, 2000).

While Defendants acknowledge that establishing negative loss causation is an affirmative defense, they attempt to sidestep this requirement by asking the Court to rule, as a matter of law, that based on "the face of the Complaint" there can be no plausible causal connection between any of the alleged misstatements and omissions and Plaintiffs' losses. Defs.' Br. at 19-21.[7] Specifically, Defendants argue the Complaint fails to plead loss causation because their misrepresentations regarding the Fund's investment objective or strategy could not have caused the Fund's NAV to be artificially inflated. *Id.* This argument fails here because Defendants' misstatements concealed the Fund's overexposure to the risk of volatility and failure to engage in adequate risk mitigation. ¶¶43, 49, 54, 56-57. Plaintiffs' losses were thus directly attributable to those misrepresentations.

Defendants rely almost exclusively on a single case that has been repeatedly distinguished.[8] The *State Street* decision essentially held that there is a loophole in the 1933 Act for mutual funds

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[7] Defendants cite dicta from *Miller v. Apropos Tech., Inc.*, No. 01 C 8406, 2003 WL 1733558, at *8 n.6 (N.D. Ill. Mar. 31, 2003) and *McCoy*, 2000 WL 1693963, at *7 for the abstract proposition that a court *could* dismiss a complaint where the "allegations clearly point to the existence of the defense." Def.'s Br. at 19. However, in those cases, the courts found that defendants had not met their burden and therefore dismissal was not warranted.

[8] The only other case to which Defendants cite, *Clark v. Nevis Capital Management, LLC*, No. 04 Civ. 2702 (RWS), 2005 WL 488641, at *18 (S.D.N.Y. Mar. 2, 2005), was decided years before *State Street* and is distinguishable because it does not address loss causation in the context of 1933 Act claims.

such that loss causation can never exist for mutual fund purchasers. 774 F. Supp. 2d at 595-96. As other courts have recognized, this simply cannot be the correct interpretation of available damages under the 1933 Act. *See, e.g.*, *Youngers v. Virtus Inv. Partners Inc.*, 195 F. Supp. 3d 499, 512 (S.D.N.Y. 2016) (rejecting the loss causation reasoning in *State Street* and holding loss causation can be adequately alleged against a mutual fund).

In rejecting the holding of *State Street*, the court in *Youngers* reasoned that since mutual fund shares are priced by a fund and according to a statutory calculation rather than being traded on a secondary market, in such situations investors consider the "expected future value of an investment" and "look to a myriad of factors" including "risk," which "could lead to an inflated valuation of the security." *Id.* at 512-13; *see also Oppenheimer*, 838 F. Supp. 2d at 1176 (rejecting *State Street's* "restrictive view of liability under the 1933 Act" because, in part, it would lead to the absurd result that mutual fund companies could lie with impunity.).

Further, other courts throughout the country have rejected the reasoning of *State Street* and recognized that the materialization of an undisclosed risk can establish loss causation in the mutual fund context. *See, e.g.*, *Evergreen*, 705 F. Supp. 2d at 95 (denying motion to dismiss and holding plaintiffs may establish loss causation by alleging a materialization of a concealed risk); *In re Charles Schwab Corp. Sec. Litig.*, 257 F.R.D. 534, 546-47 (N.D. Cal. 2009) (same); *Rafton v. Rydex Series Funds*, No. 10-CV-01171-LHK, 2011 WL 31114, at *11 (N.D. Cal. Jan. 5, 2011) (same).

This case is like *Youngers*, *Oppenheimer*, *In re Evergreen*, *Charles Schwab*, and *Rafton*, as Defendants misled Plaintiffs regarding the risks associated with the Fund's investment objectives and failure to mitigate its exposure to catastrophic losses in the event of even temporary volatility. ¶¶4, 50, 53(h), 54(d), 56. As this risk materialized, the underlying assets plummeted and the Fund suffered massive losses in capital. ¶58. Accordingly, even though the Fund's price was calculated by NAV, Plaintiffs' losses were caused by Defendants' misrepresentations and Defendants have failed to meet their heavy burden of establishing negative loss causation.

IV. THE COMPLAINT ADEQUATELY ALLEGES THAT THE DEFENDANTS WERE STATUTORY SELLERS

Section 12(a)(2) attaches liability to "statutory sellers," *i.e.*, those who (1) "passed title, or other interest in the security, to the buyer for value"; or (2) "successfully solicit[ed] the purchase, motivated at least in part by a desire to serve [their] own financial interests or those of the securities owner." *Pinter v. Dahl*, 486 U.S. 622, 642, 647 (1988). Defendants do not dispute that the Trust is a statutory seller.[9] Defs.' Br. at 21-24. And while Defendants do argue that the Individual Defendants and NLD – the Underwriter – were not sellers, the Complaint adequately alleges that they were statutory sellers under §12(a)(2) because (i) the Trustee Defendants signed the Offering Materials; (ii) the Individual Defendants and NLD, as the Underwriter, participated in the preparation of the false and misleading Offering Materials; and (iii) the Individuals Defendants and the Underwriter participated in marketing the Fund to investors.

With respect to the Trustee Defendants, Defendants contend that signing the Registration Statement is not enough to be considered a statutory seller, but it is. Defs.' Br. at 23. "[O]fficers or directors of the stock issuer who signed its registration statement are deemed to have solicited the purchase of the offered stock." *In re Ply Gem Holdings, Inc. Sec. Litig.*, No. 14-CV-3577 (JPO), 2016 WL 5339541, at *6 (S.D.N.Y. Sept. 23, 2016); *Ulta Salon*, 604 F. Supp. 2d at 1193 (defendant was a statutory seller because it signed the Prospectus, "which by definition is a document that solicits the public to acquire securities"). And although Defendants cite some limited, non-binding

[9] While Defendants appear to nominally include Defendants Caine and Parvataneni in their argument, (Defs.' Br. at 21), they make no specific argument regarding those two Defendants and any purported argument is therefore waived. *See supra* §II.B.1. In any event, Defendants Caine and Parvataneni were heavily involved in soliciting investors in the Fund. Specifically, in addition to the allegations set forth above, both were featured and quoted in promotional materials used to solicit purchasers of Fund shares, and both were compensated based upon the number of investors and performance of the Fund. ¶¶26-27.

authority for their argument, the Seventh Circuit itself has not addressed this issue, and the weight of authority supports Plaintiffs' position. Indeed, courts have found that "sign[ing] the registration statement . . . in itself is particularly 'significant for purposes of finding that a [person] is a seller.'" *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp. 2d 158, 187 (S.D.N.Y. 2003).

Moreover, the Trustee Defendants did more than simply sign the Registration Statements. For instance, the Complaint alleges that all of the Individual Defendants, and the Underwriter, "participat[ed] in the preparation of the false and misleading Offering Materials," and "solicit[ed] purchasers of Fund shares," by issuing a "Fund 'Fact Sheet'" and a "Fund 'Brochure,'" which "assured investors that the Fund had a series of sophisticated hedging and risk mitigation procedures in place to avoid major drawdowns." ¶¶47-48, 50, 52, 87. These facts further support a finding that the Individual Defendants are statutory sellers. *See*, *e.g.*, *ABN AMRO*, 595 F. Supp. 2d at 832 (defendants "actively solicited the sale" by participating in the preparation of sales documents).

As to the Underwriter, Defendants argue it was not a statutory seller because it did not "solicit[] investors to the Fund," but instead "merely 'distributed' the Fund's shares." Defs.' Br. at 23. This not only raises factual issues inappropriate for a motion to dismiss, but Defendants provide no support for this distinction and fail to explain how the distribution of shares necessarily (and as a matter of law) does not include the solicitation of investors or the passage of title, as Plaintiffs have alleged. ¶87. Defendants argue only that the Underwriting Agreement demonstrates that the Underwriter had no responsibility for the statements in the Offering Materials. Defs.' Br. at 23-24. As an initial matter, Defendants' reliance upon the Underwriting Agreement is improper on a motion to dismiss because the Court "is prohibited from considering extrinsic evidence without converting a motion to dismiss into one for summary judgment." *9557, LLC & River W. Meeting Assocs., Inc. v. Travelers Indem. Co. of Conn.*, No. 15-cv-10882, 2016 WL 464276, *1, *4 (N.D. Ill. Feb. 8, 2016) (citing *Hecker v. Deere & Co.*, 556 F.3d 575, 582-83 (7th Cir. 2009)).[10] On the merits, Defendants' argument is also unavailing because the provision they cite only says the Trust was involved in preparing the Offering Materials, not that the Underwriter had no role in that process. Defs.' Br. at Ex. 10.

In addition, Plaintiffs have alleged that the Underwriter was "responsible for the contents and dissemination of the Registration Statements and Offering Materials," ¶79, and the Statement of Additional Information prepared with the Prospectus states that "[t]he Underwriting Agreement provides that the Distributor, as agent in connection with the distribution of Fund shares, will use reasonable efforts *to facilitate the sale of the Fund's shares*." Plaintiffs' Ex. 1 at 26 (Preservation Fund's "Statement of Additional Information"), attached hereto. Plaintiffs have further alleged that the Underwriter was motivated by a desire to serve its own financial interests, ¶86, which Defendants have confirmed. Defs.' Br. at 24 (noting that NLD netted "approximately $60,000 in fees from commissions paid in connection with sales of the Fund's shares" in just one year).[11] Plaintiffs have thus sufficiently alleged NLD's involvement in the solicitation of investors in the Fund. *See, e.g.*, *In re iDreamSky Tech. Ltd. Sec. Litig.*, 236 F. Supp. 3d 824, 831 (S.D.N.Y. 2017) (finding sufficient allegations that the underwriter defendants engaged in "preparation and/or

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[10] Defendants' assertion that the Court can consider the Underwriting Agreement on this motion to dismiss because it was tangentially referenced in the Complaint is incorrect. Defs.' Br. at 24 n.9. As Defendants' own cases state, judicial notice on a motion to dismiss is appropriate only for documents that "are referred to in the complaint and [] are *central* to a claim." *Abrams v. Van Kampen Funds, Inc.*, No. 01 C 7538, 2002 WL 1160171, at *2 (N.D. Ill. May 30, 2002). The Underwriting Agreement is not central to Plaintiffs' claims. Moreover, even if the agreement was publicly filed, as Defendants claim, public records may only be considered on a motion to dismiss for "the fact that the [documents] contain certain statements, but not the truth of the statements themselves." *City of Sterling Heights*, 2013 WL 566805, at *11.

[11] There is no requirement that Plaintiffs allege that NLD "took on financial risk for the issuance of the shares," or earn a significant amount of money. *Id.*; *see Pinter*, 486 U.S. at 647 (statutory sellers must be "motivated *at least in part* by a desire to serve [their] own financial interests or those of the securities owner").

dissemination of the Registration Statement and/or Prospectus and/or the solicitation of the class" and "profited from the transaction").

Finally, Defendants' argument that Plaintiffs needed to allege that the Trustees and Trustee Defendants "were *directly* involved in soliciting sales of the Fund," is mistaken. Defs.' Br. at 23. Courts have made clear that ***indirect*** solicitation is sufficient. *See Daniels v. Blount Parrish & Co.*, 113 F. App'x 174, 176 (7th Cir. 2004) ("strict privity between the purchaser and a §12 'seller' is not required"); *see also In re Vivendi*, 381 F. Supp. 2d at 186 ("[T]he seller need not have 'personal' contact with the purchaser . . . to be liable under §12(a)(2)."). Thus, even if Defendants were not directly involved or had no personal contact with investors, they can nonetheless be statutory sellers.[12]

V. THE COMPLAINT SUFFICIENTLY ALLEGES SECTION 15 VIOLATIONS AGAINST DEFENDANTS

Defendants contend that the Individual Defendants (collectively the Trustee Defendants and Caine and Parvataneni) and NorthStar cannot be held liable as control persons for securities violations of others. However, Plaintiffs' claims under §15 need only satisfy the minimal pleading standards of Rule 8. *See Groupon*, 2013 WL 12284524, at *3. To allege a claim under §15, a plaintiff must establish three elements: (i) an underlying violation of the securities laws; (ii) the exercise of general control over the operations of the company; and (iii) the possession of "the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised." *Shah*, 348 F. Supp. 3d at 850 (quoting *Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873, 881 (7th Cir. 1992)).

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[12] The cases cited by Defendants also do not require direct contact between the seller and the investors. *See Endo v. Albertine*, 812 F. Supp. 1479, 1494 (N.D. Ill. 1993) ("[N]o strict privity between the plaintiff-purchaser and defendant-seller is required to prove liability under §12(2).").

Here, Plaintiffs have met this minimal standard by pleading (i) a primary violation of the 1933 Act claims (*Supra*); (ii) that each of the Individual Defendants was a control person of the Fund and that NorthStar was a control person of the Underwriter; and (iii) that both the Individual Defendants and NorthStar had the ability to control the misrepresentations underlying Plaintiffs' claims. *See In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 352 (S.D.N.Y. 2003) ("Section 15 claims need only be pleaded under Rule 8; a defendant is only entitled to notice that she allegedly controlled an entity that violated §11. . . . Naked allegations of control . . . will typically suffice to put a defendant on notice of the claims against her.").

Defendants argue that the Individual Defendants cannot be control persons based solely on their status as directors and trustees of the Trust. Defs.' Br. at 26. Contrary to their argument, however, Plaintiffs have alleged more than simply the status of the Individual Defendants as members of the Trust's board. In addition to their controlling positions with the Fund, the Trust, and LJM, Plaintiffs have alleged that each of the Individual Defendants actually participated in the process which allowed the sales of the shares of the Fund to be successfully completed. ¶96. Specifically, the Trustee Defendants each signed the 2015, 2016 and 2017 Registration Statements which contained the misleading statements that form the basis of Plaintiffs' claims. ¶¶20-25. Plaintiffs also pled that each of the Trustee Defendants had the power to conduct, operate and carry on the business of the Trust, and had responsibility for overseeing the Trust's risk management. ¶28. In addition, Caine and Parvataneni were directly and primarily responsible for the day-to-day management of the Fund and were responsible for determining the purchases or sales of securities for the Fund. ¶27. Moreover, both Caine and Parvataneni were featured and quoted in promotional materials used to solicit purchasers of Fund shares during the Class Period. ¶¶26-27. These allegations are sufficient to demonstrate that the Individual Defendants were control persons within the meaning of §15. *See Donohoe v. Consol. Operating & Prod. Corp.*, 30 F.3d 907, 912 (7th Cir.

1994) (allegations that the defendants "had majority control and played an active role in the day-to-day operations of the business" properly stated a claim under Section 15); *Groupon*, 2013 WL 12284524, at *3 (allegations that defendants exercised control "by virtue of their various positions and duties" were sufficient).

As to NorthStar, Defendants dispute Plaintiffs' allegation that NorthStar owns 75% of the Underwriter, NLD, and attach a document showing NorthStar's registration as a Series LLC to attempt to support its contention. Defs.' Br. at 27; Defs.' Br., Ex. 11. Importantly, Defendants do not dispute Plaintiffs' allegation that "records filed with the Financial Industry Regulation Authority" ("FINRA") show that NorthStar owns more than 75% of the Underwriter. ¶19. Instead, Defendants point to a different document, Defs.' Br., Ex. 11, to dispute their ownership. In addition, while Defs.' Br., Ex. 11 seems to indicate that NorthStar is registered as a Series LLC, it fails to demonstrate its specific corporate structure or what entities are a part of that structure, and it does not show which entity or entities owns the Underwriter. At best, Defs.' Br., Ex. 11 raises a contested issue of material fact and therefore provides an unsuitable basis for dismissal. *See United States v. LaSalle Bank, N.A.*, No. 07 C 6196, 2008 WL 4874169, at *2 (N.D. Ill. July 29, 2008) ("[T]he Seventh Circuit has been quite explicit; '[w]here the pleadings raise a contested issue of material fact, a Rule 12(b)(6) motion must be denied.'").

And while Defendants argue that NorthStar did not exercise control over the Underwriter (Defs.' Br. at 28), Plaintiffs' allegations go beyond alleging that NorthStar is a simple shareholder of the Underwriter and are more than sufficient to meet the notice pleading standard under Rule 8. The Complaint alleges that NorthStar operates out of the same headquarters as the Underwriter and that, according to FINRA documents, it owns more than 75% of the Underwriter and "direct[s] the management and policies" of the Underwriter. ¶¶19, 95. Courts have found similar allegations to be more than sufficient to state a claim under Section 15. *See, e.g.*, *Oppenheimer*, 838 F. Supp. 2d at

1181 ("parent company" was control person where SEC filings stated the parent "has the power to direct or cause the direction of management or policies of the [subsidiary]").

Moreover, whether a defendant is a control person "is a question of fact that cannot be determined at the pleading stage." *In re Motorola Sec. Litig.*, No. 03 C 287, 2004 WL 2032769, at *35 (N.D. Ill. Sept. 9, 2004).

VI. PLAINTIFFS' CLAIMS ARE TIMELY

Finally, Defendants' half-hearted argument that the claims are time-barred because the "Fund's specific holdings were disclosed in the Fund's Annual Reports" is likewise unavailing. Defs.' Br. at 29. Claims under the 1933 Act must be filed "within one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C. §77m. But contrary to their argument, Defendants' annual snapshot of the Fund's portfolio failed to disclose that the Fund was not following its stated objectives or was not employing risk controls. *See Law v. Medco Research, Inc.*, 113 F.3d 781, 785-86 (7th Cir. 1997) (statute did not begin to run for securities claim, despite grounds for suspicion, where plaintiffs did not have sufficient access to information). In addition, for all of the reasons stated above, Defendants made false and misleading statements that concealed the truth from investors.

Once again, the Seventh Circuit has cautioned that determining whether a plaintiff has sufficient facts to place him on inquiry notice "is a question of fact, and as such is often inappropriate for resolution on a motion to dismiss under Rule 12(b)(6)." *Marks v. CDW Comput. Ctrs., Inc.*, 122 F.3d 363, 367 (7th Cir. 1997).

CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss should be denied in its entirety. If this Court grants it, in whole or in part, Plaintiffs respectfully request leave to amend under Fed. R.

Civ. P. 15(a) to cure any defects. *See Blanchard v. Edgemark Fin. Corp.*, No. 94 C 1890, 2000 WL 33223385, at *2 (N.D. Ill. May 22, 2000) ("leave to amend a complaint shall be freely given when justice so requires").

DATED: March 4, 2019

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury that on March 4, 2019, I authorized the electronic filing of the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the e-mail addresses on the attached Electronic Mail Notice List, and I hereby certify that I caused the mailing of the foregoing via the United States Postal Service to the non-CM/ECF participants indicated on the attached Manual Notice List.

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Manual Notice List

The following is the list of attorneys who are **not** on the list to receive e-mail notices for this case (who therefore require manual noticing). You may wish to use your mouse to select and copy this list into your word processing program in order to create notices or labels for these recipients.

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