UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LEONARD SOKOLOW, Individually and on Behalf of All Others Similarly Situated,	)	Case No. 18-cv-01039
	)	
Plaintiffs,	)	Judge Robert M. Dow, Jr.
	)	
vs.	)	
	)	
LJM FUNDS MANAGEMENT, LTD., *et al.*,	)	
	)	
Defendants.	)	

DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF
THEIR JOINT MOTION TO DISMISS THE CONSOLIDATED COMPLAINT

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Defendants LJM Funds Management, Ltd. ("LJM"); Two Roads Shared Trust (the "Trust"); Northern Lights Distributors, LLC ("NLD"); NorthStar Financial Services Group, LLC ("NorthStar"); Mark D. Gersten, Mark Garbin, Neil M. Kaufman, and Anita K. Krug (together, the "Trustees"); Andrew B. Rogers and James Colantino (together, the "Trust Officers"); Anthony J. Caine ("Caine"); and Anish Parvataneni ("Parvataneni") (collectively, "Defendants"), by and through their attorneys, respectfully submit this memorandum of law in support of their joint Motion to Dismiss the Consolidated Complaint in its entirety, pursuant to Federal Rule of Civil Procedure 12(b)(6).

PRELIMINARY STATEMENT

In early February 2018, the CBOE Volatility Index ("VIX") experienced an unprecedented spike. Indeed, the VIX—which is a calculated benchmark that purports to measure the 30-day expected volatility in the Standard & Poor's ("S&P") 500 Index as implied from S&P 500 Index options—more than doubled over the two-day period from February 5th to 6th, from 17 to 37 (and saw intraday highs over 50). This movement reflected the VIX's sharpest spike in its 25 year history.

As a result of this unprecedented spike in the VIX, investors in the LJM Preservation and Growth Fund (the "Fund") unfortunately experienced steep declines in their investments when the Fund's net asset value ("NAV") plunged. As Plaintiffs concede, the Fund's Offering Materials made it abundantly clear that the Fund was essentially "betting against market volatility." (Compl. ¶¶ 4, 36, 54(f).)[1] Indeed, the Fund's Offering Materials disclosed specific risks about the investments the Fund would make—including in long and short put options based

[1] The Registration Statements, Prospectuses, Annual Reports, Forms N-Q and Fact Sheets, which are all publicly filed with the SEC, are referred to herein as the "Offering Materials." Further, the Consolidated Complaint (Dkt. 114) is referred to herein as the Complaint or Compl.

on the Standard & Poor's 500 Futures Index ("S&P Futures")—and those specific risks came to pass, resulting in the Fund losing nearly 80% of its NAV.

Plaintiffs subsequently commenced this action. Plaintiffs assert that because the Fund suffered losses and the Fund's name included the word "Preservation," Defendants must be liable under Sections 11 and 12(a)(2) of the Securities Act of 1933 (the "1933 Act"). Plaintiffs' bare assertions, premised largely on their mischaracterization of certain statements in the Fund's Offering Materials, fail to support any viable claims. While there is no dispute that the Fund incurred significant losses, Plaintiffs cannot use the federal securities laws as insurance against the risks of investment losses where those risks were properly disclosed—which is precisely what the Complaint seeks to do. The Court should dismiss the Complaint for a number of independent reasons.

First, Plaintiffs do not identify a single statement in the Offering Materials that was false when made. Instead, Plaintiffs simply make conclusory statements, but then gloss over or ignore the specific disclosures in the Offering Materials that addressed the very risks of which they complain that materialized in early February 2018. Indeed, the Offering Materials contained extensive and detailed disclosures concerning the Fund's investment strategy, which was to bet against market volatility—meaning the Fund would seek to profit if the market was not volatile—by investing in long and short put options based on the S&P Futures, and warned investors that the Fund's investments in such instruments carried the risk of "unlimited losses." The Offering Materials expressly disclosed not only the general risks of investing in the Fund, but also specific risks arising from derivative instruments, the Fund's use of leverage in derivative instrument trades, and the particular liquidity risks associated with the Fund's investments in these types of financial instruments. For example, the Offering Materials expressly warned investors that:

- "The Fund trades derivatives which change in price based on movements in the S&P Futures Index. It is possible that *moderate changes in the S&P Futures Index can lead to large losses* in the derivatives held by the Fund." (Ex. 1, Fund Prospectus, dated Feb. 28, 2017 ("Prospectus"), at 3 (emphasis added).)[2]

- "The derivative instruments in which the Fund may invest may be more volatile than other instruments. The risks associated with investments in derivatives also include … extreme and sudden changes in market valuation. Actual changes in the value of the derivative may not correlate perfectly with the models used by the Fund and the Fund could lose more than the principal amount invested." (*Id.*)

- "The Fund's *losses are potentially large* in a written put transaction *and potentially unlimited* in a written call transaction." (*Id.* at 4 (emphasis added).)

- Although there were risk mitigation strategies potentially available, "[t]here can be no assurance that the Fund's risk mitigation strategies will reduce risk or will be either available or cost effective." (*Id.* at 3.)

- "The value of your investment in the Fund, as well as the amount of return you receive on your investment may fluctuate significantly." (*Id.* at 2.)

- "[T]here is the risk that you could lose money through your investment in the Fund." (*Id.*)

- The Fund employs leverage, which "can result in loss of an amount substantially greater than the amount invested in the derivative." (*Id.* at 3.)

- "Liquidity risk exists when particular investments of the Fund would be difficult to purchase or sell at an advantageous time or price, possibly preventing the Fund from selling such securities quickly at the price it has valued the holding, or possibly requiring the Fund to dispose of other investments at unfavorable times or prices in order to satisfy its obligations." (*Id.* at 9.)

In addition to specific disclosures about how the Fund's derivative instruments could lead to "large" and even "unlimited" losses in the Fund, numerous other risk disclosures in the

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[2] Defendants have attached as exhibits excerpted portions of the Offering Materials cited to herein. Defendants will provide the Court with complete versions of any of the Offering Materials upon the Court's request, which are also available from the search feature on the SEC's website (www.sec.gov).

Offering Materials belie Plaintiffs' conclusory allegations. For example, Plaintiffs focus on the word "Preservation" in the Fund's name. (Compl. at 1.) The Fund's name—"Preservation and Growth Fund"—generally reflected its dual investment objective of "seek[ing] capital appreciation and capital preservation with low correlation to the broader U.S. equity market." (Ex. 1, Prospectus, at 1.) But the Offering Materials were clear that the Fund was "*not guaranteed to achieve its investment objective*." (*Id*. at 2 (emphasis added), *see also id.* at 7 ([T]he Fund might not achieve its investment objectives.").) Indeed, investors were warned that they "may lose part *or all* of [their] investment in the fund." (*Id.* at 2 (emphasis added).)

Not only do the extensive disclosures in the Offering Materials show that the statements Plaintiffs identify were not misleading, but many of those statements relate to the Fund's forward-looking objectives and past performance, which are not actionable. Neither category can sustain Plaintiffs' claims, particularly where, as here, the forward-looking statements were accompanied by clear disclaimers, and Plaintiffs do not even contend that the statements about past performance were inaccurate.

Second, Plaintiffs have not sufficiently alleged loss causation. Plaintiffs' alleged losses resulted from their investment in a mutual fund, and the shares of a mutual fund are priced based on the daily NAV using a statutory formula derived from the value of the underlying securities held in the portfolio. Because the Fund's value is tied to this statutory formula, no representation about the Fund's investment goals or strategy, true or untrue, can affect a mutual fund's share price and therefore cannot be the cause of any loss.

Third, Plaintiffs' Section 12(a)(2) claim against Caine, Parvataneni, the Trustees, the Trust Officers, and NLD fails because, in addition to the deficiencies identified above, Plaintiffs have not adequately alleged that any of Defendants were statutory "sellers," which is a requirement of Section 12(a)(2).

The Court should also dismiss Plaintiffs' claim for control person liability under Section 15 of the 1933 Act. As an initial matter, control person claims fail where, as here, the claims for primary liability fail. In addition, Plaintiffs fail to allege, as they must in the Seventh Circuit, specific facts establishing actual control over the alleged primary violators and the ability to control the specific events alleged to give rise to primary liability, *i.e.*, the statements in the Offering Materials.

Finally, to the extent Plaintiffs allege that LJM never followed the investment strategy that was stated in the Offering Materials, their claims are barred by the one-year statute of limitations applicable to each of their claims. Investors in the Fund, including Plaintiffs, were provided annual reports disclosing the Fund's specific holdings.[3] Thus, if Plaintiffs' theory is that LJM was not following the trading strategy described in the Offering Materials (which is not the case), Plaintiffs knew, or should have discovered, that to be the case when they invested, which was more than one year before they filed this action. Accordingly, the claims are time-barred.

For these reasons, and those that follow, the court should dismiss the Complaint in its entirety and with prejudice.

[3] To the extent Plaintiffs are alleging that LJM's investment strategy changed at some point after Plaintiffs invested, Plaintiffs fail to allege facts describing when and how the strategy changed, and fail to allege that any statement was untrue at the time it was made. Accordingly, beyond the statute of limitations issues, this theory, too, would fail to state a claim under Section 11 or 12(a)(2).

BACKGROUND

The Fund was launched in December 2012. (Compl. ¶ 31.)[4] The Fund, which was an open-end investment company or mutual fund, was a series of the Trust. (*Id.* ¶ 17.) Defendant LJM was the Fund's investment adviser. (*Id.* ¶ 16.) The individual defendants are members of the Trust's board, a current and former officer of the Trust, and two officers of LJM. (*Id.* ¶¶ 20-27.) Defendant NLD was the Fund's distributor. (*Id.* ¶ 18.) Defendant NorthStar is a Series LLC comprised of a number of series, one of which owns NLD, among other operating companies.

Shares in the Fund were offered pursuant to a Registration Statement, which was filed with the SEC and publicly available. (Compl. ¶ 51.) The Trust also filed annual amendments to the Registration Statement and annual and semi-annual Shareholders' Reports. (*Id.*)

As a mutual fund, shares in the Fund were priced daily based on the Fund's NAV, which was derived from the value of the underlying securities held in the portfolio. (Compl. ¶ 35; Ex 1, Prospectus, at 14; Ex. 2, Fund Semi-Annual Report, dated Apr. 30, 2016 ("Semi-Annual Rep."), at 10.) Each annual and semi-annual shareholders' report included an update on the Fund's performance and activities, as well as a detailed listing of the Fund's holdings. (*E.g.*, Ex. 3, Fund Annual Report, dated Oct. 31, 2017 ("2017 Annual Rep."), at 3-5; Ex. 2, Semi-Annual Rep., at 3-4.)

The Registration Statement described the Fund's investment strategy: the Fund attempted to specialize in short volatility strategies, and primarily sought to profit from the spread between implied and realized volatility over time by selling options. (Ex. 1, Prospectus, at 2; *see also* Ex.

[4] The factual allegations of the Complaint are taken as true only for purposes of this motion to dismiss.

4, at 2)[5].) In pursuit of this strategy, the Fund invested in long and short call and put options on S&P Futures based on a discretionary trading model. (Ex. 1, Prospectus, at 2.) Further, during periods of market downturns, the Fund would "aim to" preserve capital—but the Fund never promised that it would be able to do so. (*Id.*) In fact, the Registration Statement specifically states that "[a]n investment in the Fund is not guaranteed to achieve its investment objective" and "[y]ou may lose part or all of your investment in the fund. . . ." (*Id.*)

As the Offering Materials state, there are risks with any investment. The Offering Materials here detailed the specific risks associated with investment in the Fund and its strategy of purchasing and selling options on S&P Futures. For example, the Offering Materials disclosed that the Fund's strategy of investing in such options made the Fund subject to more volatility than other investments; that the Fund's use of leverage could "result in loss of an amount substantially greater than the amount invested in the derivative [S&P Futures]"; that "moderate changes in the S&P Futures Index [could] lead to large losses in the derivatives held by the Fund"; that the Fund's losses were potentially "large" and even "unlimited" from its written put and written call transactions in S&P Futures, respectively; and that the market had experienced increased volatility in recent years that could worsen. (Ex. 1, Prospectus, at 4.) The Complaint glosses over or ignores these critical risk disclosures, as well as the explicit warning that the kind of volatility that posed risks of "large" losses for investors in the Fund could worsen.

The risk of "large" and "unlimited" losses in the Fund's derivative investments from even "moderate changes in the S&P Futures Index" (Ex. 1, Prospectus, at 3) led the Fund to warn

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[5] The Complaint (¶¶ 62, 64) quotes from the article attached as Ex. 4, and thus the Court can appropriately consider it on this motion to dismiss. *See Abrams v. Van Kampen Funds, Inc.*, No. 01 C 7538, 2002 WL 1160171, at *2 (N.D. Ill. May 30, 2002).

specifically that there could be no assurance that the Fund's investment "objectives" of "capital preservation" and "capital appreciation" could be achieved:

> An investment in the Fund is not guaranteed to achieve its investment objective; is not a deposit with a bank; is not ensured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency and is subject to investment risks. The value of your investment in the Fund, as well as the amount of return you receive on your investment may fluctuate significantly. You may lose part or all of your investment in the fund or your investment may not perform as well as other similar investments.

(Ex. 1, Prospectus, at 2.) As the Fund was engaging in sophisticated options on futures trading that entailed the significant risks expressly described, the Offering Materials further specifically warned that "**[t]he Fund is not intended to be a complete investment program but rather one component of a diversified investment portfolio.**" (*Id*. (emphasis in original).)

In early February 2018, risks that had been specifically disclosed to investors came to pass. On February 5, 2018, the VIX experienced the sharpest one-day spike in its history, closing at twice its opening price. (Compl. ¶ 66; *see also* Ex. 4 at 2; Ex. 5.)[6] That spike in the VIX had a profound impact on the Fund—just as the Offering Materials had warned could happen—and the Fund consequently experienced large losses in its NAV.

Plaintiffs claim they were investors in the Fund, and they seek to recover from Defendants the losses resulting from the VIX spike on February 5 and February 6, 2018.

[6] The VIX is based on real-time bids and offers on options on the S&P and is designed to reflect investors' consensus view of future (30-day) expected stock market volatility. (Ex. 6.)

ARGUMENT

To survive a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), a plaintiff must allege sufficient facts, taken as true, to state a plausible claim for relief. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555–56 (2007). "[T]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice," and if "the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct," the complaint should be dismissed. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678-79 (2009).

Without converting a motion to dismiss to one for summary judgment, a court may take judicial notice of documents contained in the public record and reports, decisions, and regulations of administrative bodies. *See Abrams*, 2002 WL 1160171, at *2. A court may also consider any document that is referred to in the complaint and is central to a claim, even if that document is not attached to the complaint—including the full text of SEC filings, prospectuses, and statements that are integral to the complaint. *See id.*; *accord In re Newell Rubbermaid Inc. Sec. Litig.*, No. 99 C 6853, 2000 WL 1705279, at *3 n.2 (N.D. Ill. Nov. 14, 2000).

I. PLAINTIFFS' SECTION 11 AND 12(A)(2) CLAIMS FAIL BECAUSE THE COMPLAINT DOES NOT ALLEGE ANY MATERIAL MISSTATEMENTS.

To state a claim under Sections 11 or 12(a)(2), Plaintiffs must allege that Defendants made an untrue statement of material fact or omitted material facts in a registration statement or prospectus. *See* 15 U.S.C. §§ 77k, *l*; *Stark Trading v. Falconbridge Ltd.*, 552 F.3d 568, 573 (7th Cir. 2009) (Section 11 claim); *City of New Orleans Emps' Ret. Sys. v. PrivateBancorp, Inc.*, No. 10 C 6826, 2011 WL 5374095, at *9 (N.D. Ill. Nov. 3, 2011) (Sections 11 and 12(a)(2) claims). "To be actionable, a statement must be false or misleading at the time it was made; how things 'turn out *ex post* do not matter to liability.'" *Id.* (*quoting Eckstein v. Balcor Film Investors*, 58 F.3d 1162, 1169 (7th Cir. 1995)). Moreover, to be actionable, a misrepresentation must "significantly alter the total mix of information available to the investor." *Tabankin v. Kemper Short-Term Glob. Income Fund*, No. 93 C 5231, 1994 WL 30541, at *5 (N.D. Ill. Feb. 1, 1994) (*quoting Acme Propane, Inc. v. Tenexco, Inc.*, 844 F.2d 1317, 1322 (7th Cir. 1988), and *citing Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)). The central inquiry in determining whether statements are materially misleading is "'whether defendants' representations, taken together and in context, would have [misled] a reasonable investor' about the nature of the investment." *Nielsen v. Greenwood*, 849 F. Supp. 1233, 1242 (N.D. Ill. 1994); *see also In re Coty Inc. Sec. Litig.*, No. 14-CV-919 (RJS), 2016 WL 1271065, at *5 (S.D.N.Y. Mar. 29, 2016) (same).

Plaintiffs fail to allege any actionable misstatement, and further, extensive disclosures show the Offering Materials were not misleading. Moreover, the forward-looking statements and statements regarding the Fund's past performance to which Plaintiffs point are not actionable.

A. <u>The Offering Materials Disclosed the Risks of Investing in the Fund</u>.

Plaintiffs claim that, because the Fund incurred substantial losses, the Offering Materials must therefore contain a misstatement. Plaintiffs are wrong. Indeed, Plaintiffs cherry-pick various statements from the Offering Materials that are not even purported to be misstatements of existing fact, while ignoring extensive, specific disclosures warning investors of the risks associated with investing in the Fund and the Fund's strategy. These disclosures show the Offering Materials were not misleading as a matter of law.

Courts dismiss Section 11 and Section 12 claims where, as here, offering materials contain sufficient risk disclosures. *See Tabankin*, 1994 WL 30541, at *4 (dismissing Section 11 and Section 12(a)(2) claims where the prospectus "clearly states that there is no assurance that the objective will be achieved [and] goes on to list specific risks"); *In re VMS Sec. Litig.*, 752 F.

Supp. 1373, 1395-96, 1401 (N.D. Ill. 1990) (dismissing Section 11 and Section 12 claims for failure to plead misrepresentations because the offering materials contained detailed risk disclosures).

The Offering Materials describe the Fund's principal investment strategy, which was to invest in long and short call and put options based on a discretionary trading model. (Ex. 1, Prospectus, at 2.) Further, in bold text, the Offering Materials disclose "Principal Investment Risks," including specific risks of investing in the Fund and its strategy of purchasing and selling call and put options on S&P Futures:

- "The derivative instruments in which the Fund may invest may be more volatile than other instruments. The risks associated with investments in derivatives also include … extreme and sudden changes in market valuation. Actual changes in the value of the derivative may not correlate perfectly with the models used by the Fund and the Fund could lose more than the principal amount invested." (Ex. 1, Prospectus, at 3.)

- "The Fund trades derivatives which change in price based on movements in the S&P Futures Index. It is possible that moderate changes in the S&P Futures Index *can lead to large losses* in the derivatives held by the Fund." (*Id.* (emphasis added).)

- "The Fund's *losses are potentially large* in a written put transaction and *potentially unlimited* in a written call transaction." (*Id.* at 4 (emphasis added).)

- The Fund employs leverage, "whereby small cash deposits allow the Fund to hold contracts with greater face value, which may magnify the Fund's gains or losses. Adverse changes in the value or level of the underlying asset, reference rate or index can result in loss of an amount substantially greater than the amount invested in the derivative." (*Id.* at 3.)

- "The use of leverage may cause the Fund to liquidate portfolio positions when it would not be advantageous to do so in order to satisfy its obligations." (*Id.*)

- "There can be no assurance that the Fund's risk mitigation strategies will reduce risk or will be either available or cost effective." (*Id.*)

- "There has been increased volatility, depressed valuations, decreased liquidity and heightened uncertainty in the financial markets during the past several years. These conditions may continue, recur, worsen, or spread." (*Id.*)

- "The Fund will incur a loss as a result of a written option (also referred to as a short position) if the price of the written option instrument increases in value between the

> date when the Fund writes the option and the date on which the Fund purchases an offsetting position." (Ex. 1, Prospectus, at 4.)

In addition to these specific risks concerning the Fund's particular investing strategy in derivative instruments, the Offering Materials also had further specific warnings that investors in the Fund should diversify their investments and that there could be no guarantee that the Fund could achieve its own investment objective:

> **As with all mutual funds, there is a risk that you could lose money through your investment in the Fund. The Fund is not intended to be a complete investment program but rather one component of a diversified portfolio.**
>
> An investment in the Fund is not guaranteed to achieve its investment objective; it is not a deposit with a bank; it is not insured, endorsed or guaranteed by the Federal Insurance Deposit Corporation or any other governmental agency; and is subject to investment risks. The value of your investment in the Fund, as well as the amount of return you receive on your investment, may fluctuate significantly. You may lose part or all of your investment in the fund or your investment may not perform as well as other similar investments.

(Ex. 1, Prospectus, at 2 (emphasis in original).)

The Prospectus also included a section under the header "Additional Information About the Fund's Principal Investment Strategies and Related Risks." (Ex. 1, Prospectus, at 6.) In that section, investors were provided with further information about the Fund's specific investment strategy and the risks associated with that strategy:

- "The Fund's use of derivatives instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other more traditional investments." (*Id.* at 8.)
- "[C]ertain derivatives may create a loss greater than the amount invested." (*Id.*)
- "The market value of derivative instruments and securities may be more volatile than that of other instruments." (*Id.*)
- "The risks associated with derivatives also include the risk of increases in the 'bid/ask spread' during periods of heightened volatility." (*Id.*)

- "Risk mitigation trades also involve the risk that changes in the value of the derivative will not match those of the holdings as expected, in which case any losses on the holdings being hedged may not be reduced and may be increased." (Ex. 1, Prospectus, at 9.)

The Offering Materials also disclosed liquidity risks:

- "Liquidity risk exists when particular investments of the Fund would be difficult to purchase or sell at an advantageous time or price, possibly preventing the Fund from selling such securities quickly at the price it has valued the holding, or possibly requiring the Fund to dispose of other investments at unfavorable times or prices in order to satisfy its obligations." (Ex. 1, Prospectus, at 9.)

The Offering Materials also disclosed specific risks associated with spikes in volatility. For example, the 2016 Annual Report stated that "[d]ramatic fluctuations in the U.S. equity market and sharp increases in volatility tend to stress the LJM portfolios." (Ex. 7, Fund Annual Report, dated Oct. 31, 2016 ("2016 Annual Rep."), at 1.) As another example, the 2015 Annual Report stated that "as expected with a directional swing and volatility spike of that magnitude [the largest intraday VIX spike up to then], the Fund experienced severe immediate losses." (Ex. 8, Fund Annual Report, dated Oct. 31, 2015 ("2015 Annual Rep."), at 2.)[7]

Plaintiffs attempt to minimize the overwhelming number of specific disclosures by simply alleging that the Offering Materials' disclosure regarding the risk of losing money was "boilerplate." (Compl. ¶ 53(g).) Plaintiffs mischaracterize this disclosure, stating that it "falsely and misleadingly indicated the Fund was subject to the same risks as any other mutual fund, without disclosing the Fund's uniquely excessive risks." (*Id.*) It does no such thing. Indeed, the

[7] Given these extensive disclosures, Plaintiffs' allegations that Defendants violated Items 303 and 503, which require explanations of a company's financial condition and risk factors, fail. (Compl. ¶¶ 55-57.) Further, Plaintiffs claim the "Fund lacked adequate risk controls and oversight" (*e.g.*, *id.* ¶ 54(h)), but allegations concerning corporate governance cannot be bootstrapped into a federal securities law claim. *See Kademian v. Ladish Co.*, 792 F.2d 614, 622 (7th Cir. 1986) ("Without more, [the omission] is simply a failure to reveal a breach of fiduciary duty, and this court has already held . . . that a plaintiff may not 'bootstrap' a state law claim into a federal case.").

disclosures recited above confirm that the unique risks applicable to this particular Fund were disclosed to investors with reasonable and more than sufficient detail. Contrary to Plaintiffs' conclusory assertion, the disclosures contained in the Offering Materials fully revealed the risks of investing in the specific types of derivative financial instruments that the Fund would make and with sufficient specificity to warrant the attention of a reasonable investor. Such disclosures are sufficient. *See Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2, 5, 9 (2d Cir. 1996) (rejecting plaintiffs' argument that warnings should be ignored as "boilerplate," reasoning "[a] reasonable investor could not have read the prospectuses without realizing that, despite the use of balancing in an attempt to minimize the impact of fluctuating interest rates, a significant downturn in interest rates could decrease the value of the Trusts and decrease earnings").

Plaintiffs also contend that these disclosures must be misleading, based on reasons that are conclusory or dependent entirely on the size of the loss. But again, Plaintiffs' reasons improperly disregard the Offering Materials' clear and extensive disclosures. Courts have dismissed Section 11 and Section 12 claims where plaintiffs, as here, have ignored clear disclosures. *See Tabankin*, 1994 WL 30541, at *5 (dismissing Section 11 and Section 12 claims because when the "statements identified by the [plaintiffs] are read in conjunction with the rest of the disclosures, it is clear that those statements cannot form the basis for misrepresentation claims"); *In re VMS*, 752 F. Supp. at 1395-96, 1401 (dismissing Section 11 and Section 12 claims for failure to plead misrepresentations because the offering materials contained detailed risk disclosures); *Olkey*, 98 F.3d at 9 ("This court has consistently affirmed Rule 12(b)(6) dismissal of securities claims where risks are disclosed in the prospectus."); *Panther Partners, Inc. v. Ikanos Commc'ns, Inc.*, 538 F. Supp. 2d 662, 670 (S.D.N.Y. 2008) (dismissing claim where "risk disclosures made were more than adequate"); *see also La Pietra v. RREEF America,* *LLC*, 738 F. Supp. 2d 432, 442-43 (S.D.N.Y. 2010) (dismissing Section 10(b) claims where fund disclosures belied plaintiff's allegations).

Further, Plaintiffs point to the statement in the Offering Materials that the Fund's "investment in illiquid securities would not exceed 15% of its net assets," and claim that it was misleading because Caine later stated the "Fund losses had been exacerbated by a 'substantial lack of market liquidity'." (Compl. ¶ 54(c).) Plaintiffs do not allege, however, that the Fund ever invested more than 15 percent of the Fund's assets in illiquid securities. Nor could they; the Offering Materials show that the Fund invested in exchange-traded futures and options (*id.* ¶¶ 46-47; Ex. 3, 2017 Annual Rep., at 3-5), which meet the definition in the Investment Company Act of 1940 of "liquid securities" because they were capable of being sold within seven days. *See* 17 C.F.R. 270.2a-7(18).

At bottom, Plaintiffs attempt to use the securities laws as investment insurance—which the Supreme Court has foreclosed. *See generally Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (the federal securities laws are "not to provide investors with broad insurance against market losses"); *Olkey*, 98 F.3d at 8 ("To show misrepresentation, the complaint must offer more than allegations that the portfolios failed to perform as predicted."). Plaintiffs' claims nonetheless depend on a liberal use of hindsight to second-guess the Fund's investments, despite the plethora of specific disclosures about the nature of the derivative instrument investments the Fund was making and the many warnings that such investments carried the risk of large and even unlimited losses. Federal courts have been clear, however, that a plaintiff cannot plead a Section 11 or Section 12 claim by "hindsight." *See, e.g., In re ProShares Trust Sec. Litig.*, 889 F. Supp. 2d 644, 655-56 (S.D.N.Y. 2012), *aff'd* 728 F.3d 96 (2d Cir. 2013) (dismissing Section 11 and Section 15 claims improperly premised on "20/20 hindsight" theory); *Castlerock Mgmt., Ltd. v.*

Ultralife Batteries, Inc., 114 F. Supp. 2d 316, 322-23 (D.N.J. 2000) (dismissing Section 11 and Section 12 claims based upon a legally deficient "hindsight" theory).

B. Plaintiffs' Claims Are Improperly Premised on Forward-Looking Statements and Statements Regarding the Fund's Past Performance, Which Plaintiffs Never Allege Are Inaccurate.

Beyond the fact that the extensive disclosures contained in the Offering Materials were not misleading, many of the statements Plaintiffs identify relate to the Fund's forward-looking objectives and the Fund's past performance—which Plaintiffs never even claim are inaccurate. Such statements are not actionable as a matter of law.

Plaintiffs identify statements concerning the Fund's investment objectives:

- The Fund's investment objective is to "*seek* capital appreciation and capital preservation with low correlation to the broader U.S. equity market." (Compl. ¶ 53(a) (emphasis added).)
- The Fund "*aims* to preserve capital, particularly in down markets (including major market drawdowns), through using put option spreads as a form of mitigation risk." (*Id.* ¶ 53(b) (emphasis added).)
- The Fund is "*constantly improving* risk management and evolving to manage an ever-growing number of market scenarios." (*Id.*, ¶ 53(e) (emphasis added).)
- The Fund provides 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." (*Id.* ¶ 53(i) (emphasis added).)
- The Fund's strategies "*aim* to contain risk during extreme events to create a positive, uncorrelated stream of returns over the long term." (*Id.* ¶ 53(i) (emphasis added).)
- The Fund "*attempts to* balance the portfolio by entering into specific risk mitigation trades in an effort to mitigate losses during extreme events." (*Id.* ¶ 36 (emphasis added).)

These statements, all of which are forward-looking investment objectives and accompanied by clear statements about the significant risks of the Fund's investment strategy, are not actionable. *See Tabankin*, 1994 WL 30541, at *4-5 (dismissing plaintiffs' Section 11 claim because "[i]t is not tenable to base a securities fraud claim on a general statement of the Fund's objective when the Prospectus clearly states that there is no assurance that the objective will be achieved, goes on to list specific risks associated with the particular Fund, and the plaintiffs' loss results from those very risks"); *Scott v. Gen. Motors Co.*, 605 Fed. App'x 52, 54 (2d Cir. 2015) (affirming dismissal of Section 11 claim because statement regarding defendant's "aim" was inactionable) (citation omitted); *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 (dismissing Section 11 and 12 claims, noting parenthetically that "generalized statements of optimism" are not actionable) (citation omitted); *see also Sequel Capital, LLC v. Rothman*, 2003 WL 22757758, at *12 (N.D. Ill. Nov. 20, 2003) (in Rule 10b context, stating "[m]aterial misstatements cannot be 'forward-looking . . . generalized statements of optimism that are not capable of objective verification'"). Moreover, the Fund's Prospectus expressly warned that "[a]n investment in the Fund is not guaranteed to achieve its investment objective. . . and is subject to investment risks," which the Offering Materials specifically described in stark language. (Ex. 1, Prospectus, at 2.)

Plaintiffs' allegations regarding statements concerning the Fund's "historical" performance also are not actionable. (Compl. ¶¶ 53(d), (e), (f).) Each of the statements Plaintiffs identify, which are listed below, were copied from the Fund's annual reports and summarizes the Fund's performance in the *prior year*:

- The Fund can effectively mitigate risk through its "iterative portfolio management approach that has historically maximized upside recovery potential relative to portfolio risk" and through its "techniques . . . that have *historically* provided for the recovery of losses within a reasonable time frame." (Compl. ¶53(d) (emphasis added); Ex. 9, Fund Annual Report dated Oct. 31, 2014 ("2014 Annual Rep.") at 2.)

- "When 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." (Compl. ¶ 53(e) (emphasis added); Ex. 8, 2015 Annual Rep., at 1.)

- "The higher implied volatility levels *created* additional opportunities to create favorable risk/reward profiles and ultimately profit." (Compl., ¶ 53(e) (emphasis added); Ex. 8, 2015 Annual Rep., at 1.)

- When implied volatility *experienced* "the largest intraday spike in the history of available intraday data," the Fund's losses were limited because the Fund had "the experience and risk management tools to control losses and position the portfolio for a quick recovery. In fact, the Fund recovered a majority of the losses over the next month." (Compl., ¶ 53(e) (emphasis added); Ex. 8, 2015 Annual Rep., at 1-2.)

- 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." (Compl., ¶ 53(f) (emphasis added); Ex. 7, 2016 Annual Report, at 1.)

Importantly, Plaintiffs fail to allege that any of the representations about the Fund's past performance were inaccurate. This dooms Plaintiffs' claims because a violation of the securities laws cannot be premised upon a company's disclosure of accurate historical information. *See Panther Partners*, 538 F. Supp. 2d at 668 (analyzing Sections 11 and 12 claims, stating "accurate statements of historical fact . . . are non-actionable"); *Wilbush v. Ambac Fin. Grp., Inc.*, 271 F. Supp. 3d 473, 489 (S.D.N.Y. 2017) (assessing misstatement under alleged Rule 10b violation). Indeed, courts expressly reject the claim Plaintiffs appear to be making: not that the historical statements were inaccurate, but that statements about the Fund's past performance created an implicit promise about the Fund's future. *See In re Coty*, 2016 WL 1271065, at *6 (rejecting argument, which "has no basis in securities law"); *In re Duane Reade Inc. Sec. Litig.*, No. 02 CIV. 6478 (NRB), 2003 WL 22801416, at *6 (S.D.N.Y. Nov. 25, 2003) (in Section 10(b) context, stating "Defendants may not be held liable under the securities laws for accurate reports of past successes, even if present circumstances are less rosy").

Moreover, the Offering Materials expressly disclaimed that the Fund's historical performance guaranteed future results, warning that "the Funds' past performance . . . may not be an indication of how the Fund will perform in the future." (Ex. 1, Prospectus, at 4.) In the face of this clear disclosure, statements regarding the Fund's historical performance cannot sustain Plaintiffs' misrepresentation claim. *E.g., In re VMS*, 752 F. Supp. at 1395-96, 1401; *Olkey*, 98 F.3d at 9.

For all of these reasons, Plaintiffs failed to allege any actionable misrepresentation, and thus, the Court should dismiss their Section 11 and Section 12(a)(2) claims.

II. PLAINTIFFS' SECTION 11 AND SECTION 12(A)(2) CLAIMS FAIL BECAUSE THE COMPLAINT DOES NOT ALLEGE LOSS CAUSATION.

Plaintiffs' Section 11 and Section 12(a)(2) claims fail for the additional, independent reason that the allegations in the Complaint show the allegedly misleading statements did not cause Plaintiffs' losses. 15 U.S.C. §§ 77k(e), 77*l*(b). Where, as here, it is apparent from the face of a complaint that the alleged loss is not causally connected to the misrepresentations at issue—that is, there is no loss causation—a complaint should be dismissed. *See generally Miller v. Apropos Tech., Inc.*, 01 C 8406, 2003 WL 1733558, at *8 n.6 (N.D. Ill. Mar. 31, 2003) (noting that "affirmative defenses such as the absence of loss causation can be grounds for dismissal under Rule 12(b)(6)"); *Evergreen Fund, Ltd. v. McCoy*, 00 C 0767, 2000 WL 1693963, at *7 (N.D. Ill. Nov. 6, 2000) ("[L]oss causation, an affirmative defense, . . . will support a motion to dismiss under Rule 12(b)(6) when a plaintiff's allegations clearly point to the existence of the defense.").

The Complaint alleges that Plaintiffs' losses resulted from their investment in the Fund, which is a mutual fund. Unlike the value of an issuer's stock, the Fund's shares have no intrinsic value, but instead are priced solely based upon the value of the assets that the mutual fund holds each day. *See In re State Street Bank & Trust Co. Fixed Income Funds Inv. Litig*, 774 F. Supp. 2d 584, 590 (S.D.N.Y. 2011). Indeed, as with all mutual funds, the price of a share in the Fund is derived from the Fund's daily net asset value (or NAV)—a fact that is confirmed by the Complaint and the Offering Materials. (Compl. ¶ 35; Ex. 1, Prospectus, at 13.) The NAV is determined using a statutory formula based on the closing prices of the underlying securities owned by the portfolio. *See In re State Street*, 774 F. Supp. 2d at 590.

In *State Street*, as here, the plaintiffs alleged that a mutual fund's offering documents misrepresented the description and investment objective of the fund, and the risks of investing in the fund. 774 F. Supp. 2d at 585. In moving to dismiss, the defendants in *State Street* argued that no possible loss causation existed on the face of the complaint because the price of a mutual fund's shares is not determined by trading on a secondary market, but by a fund's NAV. *Id.* at 590. Because the NAV is a statutorily defined formula based upon the funds' underlying asset holdings and cannot be artificially inflated by any statements in a registration statement or prospectus, "alleged misrepresentations regarding a fund's investment objective and holdings . . . can have no effect on a fund's share price." *Id.* The plaintiffs in *State Street* disagreed and argued that the fund's investment objective downplayed the risk of investing in the fund, and when those risks "materialized," it caused a commensurate decline in the fund's NAV. *Id.* at 591.

Although the court noted that "Plaintiff's theory . . . is not without support in the case law," citing certain other district court rulings, it nonetheless concluded that dismissal of the claims was proper because of "the plain language of sections 11(e) and 12(a)(2), which requires a connection between the alleged material misstatement and a diminution in the security's value." *Id.* at 595. The court held that "where the NAV does not react to any of the misstatements in the Fund's prospectus, no connection between the alleged material misstatement and a diminution in the security's value has been or could be alleged." *Id.* at 596. In so holding, the court rejected the conclusions of the courts who agreed with the plaintiffs' theory, stating that those cases each "appear[ed] to be reasoning from effect to cause . . . with a policy rationale" and ignored the fact that "[i]t is the causal connection between the misrepresentation and the drop in the value of the security that Congress put in the . . . text [of Sections 11(e) and 12(a)(2)]." *Id.* at 594-95.[8]

Because the shares of a mutual fund are determined only based on the NAV, the price of "shares in a mutual fund . . . is unaffected by alleged misrepresentations and omissions concerning the fund itself." *Clark v. Nevis Capital Mgmt., LLC*, 04 CIV.2702(RWS), 2005 WL 488641, at *18 (S.D.N.Y. Mar. 2, 2005). Thus, none of the alleged misstatements could have caused Plaintiffs' alleged losses in the Fund. Instead, any alleged losses resulted from a decline in NAV due to a collapse in the value of the underlying securities the Fund held. Accordingly, the face of the Complaint shows that Plaintiffs have not pled, and cannot plead, loss causation. The Court should therefore dismiss Plaintiffs' Section 11 and Section 12(a)(2) claims.

III. PLAINTIFFS' SECTION 12(A)(2) CLAIM ALSO FAILS BECAUSE THE NAMED DEFENDANTS WERE NOT STATUTORY SELLERS.

Plaintiffs' Section 12(a)(2) claim against the Trustees, the Trust Officers, Caine, Parvataneni, and NLD fails for the additional reason that Plaintiffs fail to adequately allege, as they must, that any of these Defendants offered or sold a security, through interstate commerce, using a prospectus that contained a material misrepresentation or omission of material fact. *See* 15 U.S.C. § 77*l*(a)(2); *Daniels v. Blount Parrish & Co.*, 308 F. Supp. 2d 886, 888 (N.D. Ill. 2004). In *Pinter v. Dahl*, the U.S. Supreme Court held that a "seller" for purposes of Section 12 includes those who pass title and those who "successfully solicit[] the purchase, motivated at

[8] Some courts have disagreed with *State Street*'s conclusion that loss causation cannot be proven as a matter of law in claims involving mutual funds, preferring instead to leave the issue of whether a mutual fund is excluded from Section 11 and Section 12(a)(2) to Congress. *E.g.*, *In re Oppenheimer Rochester Funds Grp. Sec. Litig.*, 838 F. Supp. 2d 1148, 1175-76 (D. Colo. 2012). Defendants submit that the logic of *State Street* is sound, the case correctly applies current law, and should result in the dismissal of Plaintiffs' claims.

least in part by a desire to serve [their] own financial interests or those of the securities owner." 486 U.S. 622, 647 (1988); *see also Schlifke v. Seafirst Corp.*, 866 F.2d 935, 940 (7th Cir. 1989). Where, as here, the complaint does not allege that the defendants had direct contact with plaintiffs or played an active role in solicitation, a claim under Section 12(a)(2) must fail as a matter of law. *See Endo v. Albertine*, 812 F. Supp. 1479, 1494 (N.D. Ill. 1993) (dismissing Section 12(a)(2) claim where plaintiffs did not allege "any contact between themselves and these defendants or any meaningful participation or solicitation by these defendants in the sale"); *Paul J. Maton, P.C. v. Arthur Andersen & Co.*, 1991 WL 131184, at *3 (N.D. Ill. July 5, 1991) (dismissing Section 12(a)(2) claim where "complaint fail[ed] to allege that any of these defendants played an active role in soliciting investors in [the] securities").

In the Complaint, Plaintiffs simply allege in conclusory fashion that "Defendants were sellers and offerors and/or solicitors . . . and were motivated by a desire to serve their own financial interests or those of the Fund or LJM." (Compl. ¶ 86.) This conclusory recital of the language of the Supreme Court's *Pinter* decision is insufficient. *See Twombly*, 550 U.S. at 555 ("[A] formulaic recitation of the elements of a cause of action will not do."). Further, while Plaintiffs attempt to lump all defendants together and assert that their "actions of solicitation included participating in the preparation of" the Offering Materials and "participating in marketing the shares" of the Fund (Compl. ¶ 87), Plaintiffs fail to specify any conduct concerning the Trustees, the Trust Officers, Caine, Parvataneni, or NLD. Thus, the allegation fails to sustain their claim. *See Beaman v. Souk*, 10-CV-1019, 2011 WL 832506, at *5 (C.D. Ill. Mar. 3, 2011) (finding that pleading as a group rather than on an individual basis "is not sanctioned by Rule 8(a)"); *Schwartzco Enter. LLC v. TMH Mgmt., LLC*, 60 S. Supp. 3d 331, 356

(E.D.N.Y. 2014) (under Rule 8(a), "Plaintiffs cannot hide behind 'group pleading' of the sort here that fails to distinguish between the defendants").

As to the Trustees and Trust Officers, the only "acts of solicitation" or "participation in the marketing" are the generic allegations that they signed the 2015-2017 Registration Statements. Courts have routinely dismissed outright Section 12 claims against defendants who merely signed a registration statement, holding that such defendants are *not* statutory sellers. *See Citiline Holdings, Inc. v. iStar Fin., Inc.*, 701 F. Supp. 2d 506, 512 (S.D.N.Y. 2010) (noting that "every Court of Appeals to have considered the issue . . . has held that an individual's signing a registration statement does not itself suffice as solicitation under Section 12(a)(2)"); *Xiang v. Inovalon Holdings*, 254 F. Supp. 3d 635, 645 (S.D.N.Y. 2017). In *Citiline*, the Court noted that "[w]hile Section 11 expressly imposes liability upon every signer of the registration statement . . . Section 12 does not do so. Plaintiffs' position would render this distinction a nullity and is, in any event, inconsistent with [the Supreme Court's] statement that Congress did not intend to impose liability under Section 12 for mere participation in unlawful sale transactions." 701 F. Supp. 2d at 512. Absent from the Complaint is any allegation that the Trustees and Trust Officers had any contact with any Plaintiff or investor, much less were directly involved in soliciting sales of the Fund.

And contrary to any suggestion that NLD actively solicited investors to the Fund, NLD (which did not sign the Registration Statement) merely "distributed" the Fund's shares, pursuant to an Underwriting Agreement. (Ex. 1, Prospectus, at 24; Compl. ¶ 18; Ex. 10, Underwriting Agt.) The Offering Materials and the Underwriting Agreement make clear that NLD did not have the responsibilities of a typical underwriter that works on an initial public offering ("IPO") for a stock. As reflected in the Underwriting Agreement, which was publicly filed, the Offering

Materials were prepared by the Trust, and NLD had no responsibility for statements in the Offering Materials concerning the Fund, its strategy, or its performance. (Ex. 10, Underwriting Agt., §7(d)(x).)[9] Indeed, unlike an underwriter for an IPO, which may receive millions of dollars in fees for its firm commitment to underwrite the shares offered in the IPO and its active participation in soliciting investors, there is no allegation that NLD had any commitment to sell any number of shares or to engage in any active solicitation of investors, and NLD netted only approximately $60,000 in fees from commissions paid in connection with sales of the Fund's shares in the year ended October 31, 2017. (Ex. 3, 2017 Annual Rep., at 16.) Given NLD's limited role as the Fund's distributor, Plaintiffs nowhere allege (nor could they) that NLD ever took on financial risk for the issuance of the shares or worked closely with management to issue the Fund's shares or actively solicit Plaintiffs.

In *Pinter*, the Supreme Court held that Section 12 does not impose liability for "mere participation" or on "participants collateral to the offer or sale." 486 U.S. at 650. NLD (as well as Caine and Parvataneni) were precisely the collateral participants that fall outside the scope of Section 12 liability, and Plaintiffs have not stated, and cannot state, any facts to the contrary.

IV. <u>PLAINTIFFS' CONTROL PERSON CLAIMS UNDER SECTION 15 FAIL</u>.

Liability under Section 15 of the 1933 Act requires that Plaintiffs plead and prove a primary violation of Section 11 or Section 12(a)(2). *See Starr v. !Hey, Inc.*, No. 01 C 6087, 2003 WL 21212596, at *4 (N.D. Ill. May 23, 2003). Because Plaintiffs have failed to allege a primary violation under Sections 11 or 12(a)(2), the Section 15 claim must be dismissed for this reason alone. *See In re Midway Games, Inc. Sec. Litig.*, 332 F. Supp. 2d 1152, 1172 (N.D. Ill. 2004)

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[9] Because Plaintiffs refer to and rely on the Underwriting Agreement in the Complaint (¶ 18) and it was publicly filed, this Court may consider it on a motion to dismiss. *See Abrams*, 2002 WL 1160171, at *2; *In re Newell Rubbermaid Inc.*, 2000 WL 1705279, at *3 n.2.

("Where a plaintiff fails to state a claim against the 'controlled person,' the claim against the controlling person fails as well.").

Even assuming *arguendo* that a claim for primary liability was properly stated (and it was not), the Section 15 claim should still be dismissed. In the Seventh Circuit, to establish control person liability, Plaintiffs must plead the alleged controlling person *both*: (1) *actually* exercised general control over the operations of the alleged primary violator, *and* (2) had the power or ability to control the specific transaction that is alleged to have given rise to liability, namely, the statements made in the Offering Materials.[10] *See Donohoe v. Consol. Operating & Prod. Corp.*, 30 F.3d 907, 911-12 (7th Cir. 1994). Plaintiffs have not adequately pled either prong of this two-part test. Instead, Plaintiffs' control person allegations consist largely of boilerplate legal conclusions. Courts readily reject control person claims based on such self-serving legal conclusions, such as Plaintiffs' conclusory allegation that each defendant "was a control person." (Compl. ¶¶ 93-95); *see Starr*, 2003 WL 21212596, at *4 (dismissing Section 15 claim where plaintiff "self-servingly plead[ed] a bare legal conclusion – that the individual and corporate defendants were control persons"); *Mancini v. Prudential-Bache/Fogelman Harbour Town Props., L.P.*, No. 90 C 5213, 1991 WL 171966, at *8 (N.D. Ill. Sept. 3, 1991) (finding allegations that defendant "is a 'controlling person'" insufficient for purposes of Section 15 claim).

Similarly, Plaintiffs' claim that "[e]ach of the defendants . . . otherwise participated in the process which allowed the sale of the shares of the Fund to be successfully completed" (Compl.

[10] The same analysis is used to assess the elements of a control person claim under Section 15 of the 1933 Securities Act as under Section 20(a) of the 1934 Securities and Exchange Act. *E.g.*, *Craig v. First Am. Capital Res., Inc.*, 740 F. Supp. 530, 537 (N.D. Ill. 1990). Accordingly, cases involving Section 20(a) control person claims are instructive.

¶ 96) is deficient because it is an improper blanket conclusion, devoid of facts specifying what "process" is at issue, which defendant purportedly participated in that process, and how any defendant purportedly participated in that process.[11] *See Johnson v. Tellabs, Inc.*, 262 F. Supp. 2d 937, 944 (N.D. Ill. 2003) ("A plaintiff that solely attaches bare legal conclusions to narrated facts that fail to outline the bases of his claims does not satisfy federal pleading requirements."). Plaintiffs' conclusory allegations do not suffice to support either prong of a control person claim. *See W. Bend Mut. Ins. Co. v. Schumacher*, 844 F.3d 670, 675 (7th Cir. 2016) (stating that on a 12(b)(6) motion, a court should disregard any portion of the complaint that consists of "no more than conclusions").

As to the Trustees and Trust Officers, Plaintiffs merely rely on their status as such as their basis for Section 15 liability. This bare assertion does not satisfy the standard necessary to state a control person claim. Indeed, Plaintiffs merely allege in conclusory fashion that the Trustees were members of the Trust's board and thus they had "the power to conduct, operate and carry on the business of the Trust, and responsibility for overseeing the Trust's risk management." (Compl. ¶ 28.) Not even conclusory allegations such as these are made against the Trust Officers. Plaintiffs further allege that each was a control person by virtue of their position as a director/trustee. (*Id.* ¶ 93.) It is well settled, however, that boilerplate allegations such as these alone cannot serve as the basis for a Section 15 claim. *Starr*, 2003 WL 21212596, at *4 ("Courts within this District have consistently held that a plaintiff may not premise control

[11] Plaintiffs' allegation is further inadequate because it improperly lumps all of the defendants together rather than pleading particularized allegations on an individual basis. *See Beaman*, 2011 WL 832506, at *5 (finding that pleading as a group rather than on an individual basis "is not sanctioned by Rule 8(a)"); *Muhammad*, 2009 WL 637112, at *2 (finding claims violated FRCP 8(a) because they consisted of "blanket allegations against entire groups of individual defendants, but do not describe how each individual actor within the group contributed to the alleged harm").

person liability solely upon status within the company"); *Desai v. General Growth Props., Inc*. 654 F. Supp. 2d 836, 862-63 (N.D. Ill. 2009).

The only two facts Plaintiffs allege in an attempt to show that NorthStar controlled NLD are that: (i) "NorthStar, through its more than 75% ownership interest, directed the management and policies of [NLD]"; and (ii) NorthStar "operated out of the same principal place of business" as NLD. (Compl. ¶ 95.) These allegations fail to establish either prong necessary to adequately state a claim for control person liability under the Seventh Circuit's test.

First, Plaintiffs' allegation that NorthStar directly owns 75% of NLD (Compl. ¶ 95) is wrong. NorthStar is a Delaware Series LLC business structure, comprised of three Series; one of those Series—Series 1—wholly owns NLD, along with other operating companies. (*See* Ex. 11 (showing NorthStar's registration as a Series LLC)); 6 Del. Code § 18-215(a).[12] Thus, contrary to Plaintiffs' allegation, NorthStar itself does not have a direct ownership interest in NLD.

In any event, status as a shareholder, by itself, is insufficient to state a claim for control person liability. *See Desai*, 654 F. Supp. 2d at 863 (finding control person claim based only on defendants' status as shareholder to be improperly pleaded). In *Desai*, the court found plaintiff's allegation that "by virtue of defendants' status as . . . shareholders, they had and exercised the power to 'engage in the unlawful acts and conduct complained of herein'" was a "bare legal conclusion" that warranted dismissal. *Id.* Plaintiffs' allegations here suffer from the same deficiencies; Plaintiffs merely (and incorrectly) allege NorthStar's shareholder status, without any supporting facts as to why that status gives it control.

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[12] "[A] Court may take judicial notice of matters of public record without converting a 12(b)(6) motion into a motion for summary judgment." *George v. Kraft Foods Glob., Inc.*, 674 F. Supp. 2d 1031, 1044 (N.D. Ill. 2009). NorthStar's registration as a Delaware Series LLC is a matter of public record and is thus appropriate for consideration on a motion to dismiss.

Second, Plaintiffs' allegation that NorthStar operated out of the same place of business as NLD is insufficient to state any control person claim. (Compl. ¶ 95.) To exercise general control, the alleged controlling person must be involved in the allegedly controlled person's operations. *E.g.*, *Donohoe*, 30 F.3d at 911. Allegations that two companies shared the same office building hardly suffice to show that one company was involved in the day-to-day operations of the other company. *See generally Starr*, 2003 WL 21212596, at *4 (courts in this District "have consistently held" that plaintiffs cannot state a claim for control person liability based solely upon allegations of status).

Finally, Plaintiffs fail to allege well-pled facts, as they must, that NorthStar actually controlled, or possessed the ability to control, the "specific transaction" at issue here, which relates to the Offering Materials. *See Craig*, 740 F. Supp. at 537 (dismissing Section 15 control person claim where complaint was devoid of any allegation that defendant had specific control over the activity on which the primary violation was based); *see also 766347 Ontario Ltd. v. Zurich Capital Markets, Inc.*, 249 F. Supp. 2d 974, 984-85 (N.D. Ill. 2003) (dismissing Section 20(a) control person claim where Plaintiff failed to plead sufficient factual basis for the "specific control" prong). Instead, Plaintiffs merely allege the conclusory assertion that NorthStar "controlled the day-to-day management" of NLD. (Compl. ¶ 95.) That bare allegation does not suffice. *See Johnson*, 262 F. Supp. 2d at 958–59 (allegation that defendants "had direct and supervisory involvement in the day-to-day operations of the Company" was insufficient to assert control over the specific activity to support a control person claim).

Because Plaintiffs fail to adequately plead either prong of the Seventh Circuit's control person test, the Court should dismiss their Section 15 claim.

V. PLAINTIFFS' CLAIMS ARE TIME-BARRED.

Even if Plaintiffs could allege a material misstatement (and, as discussed above, they cannot), any claims based on such a misstatement would be time-barred. Section 13 of the 1933 Act requires each of Plaintiffs' claims be brought within "one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C § 77m.[13]

Inasmuch as Plaintiffs allege that LJM never followed the investment strategy described in the Offering Materials, Plaintiffs' claims are barred by the applicable one-year statute of limitations. The Fund's specific holdings were disclosed in the Fund's Annual Reports, including for the years 2015, 2016, and 2017. (*See* Ex. 3 at 3-5; Ex. 7 at 3-4; Ex. 8 at 4-5.) Each Annual Report, including those issued at the beginning of the class period in 2015, disclosed investment positions, and there is no allegation that the types of positions the Fund held changed. Plaintiffs did not file this action until February 9, 2018, which is more than one year after they reasonably should have discovered the alleged misstatements in 2015. Accordingly, the Court should dismiss Plaintiffs' claims as time-barred.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court enter an order dismissing the Complaint in its entirety and with prejudice.

[13] Because Section 15(a) liability is predicated upon a violation of Section 11 or Section 12, the same limitations period governs a claim under Section 15(a). *See Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981).

Dated: February 4, 2019 Respectfully submitted,

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