UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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

DEFENDANTS' REPLY IN FURTHER SUPPORT OF
<u>THEIR JOINT MOTION TO DISMISS THE CONSOLIDATED COMPLAINT</u>

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In their Opposition (Dkt. 159 ("Opp.")), Plaintiffs seek to avoid the actual language in the Offering Materials; they rarely quote complete sentences from those documents or accurately characterize their content. For good reason: when the Offering Materials are read in full, as the law requires, they make clear that the Complaint fails to allege any actionable misstatement. The Offering Materials—which discuss in detail the Fund's trading strategies, including the purchase and sale of particular options on futures contracts the Fund would trade, and the risks associated with those trading strategies—would not have misled a reasonable investor. Indeed, the plainly-disclosed risks of "large," "severe immediate," and even "unlimited" losses to the Fund from its "shorting-volatility" strategy came to pass during an unprecedented spike in volatility.

Unable to state a claim based upon statements contained in the Offering Materials, Plaintiffs fabricate statements the Fund never actually made. For example, Plaintiffs repeatedly state that the Fund was promoted as being "conservative" and "low risk." (Opp. 1, 3, 4, 5, 6, 13, 16, 18.) But the words "conservative" and "low risk" appear nowhere in the Offering Materials. And the Fund's investment objective, or aspiration, to make money for investors while seeking to preserve capital during downturns was a goal—not a guarantee—which was underscored by the Prospectus' express disclosure that "[a]n investment in the Fund is not guaranteed to achieve its investment objective." (Ex. 1, Dkt. 151-2, at 2.)

As the Offering Materials plainly disclosed, the Fund's trading strategy was a "bet" against market volatility. Investors were told that the Fund invested in derivative instruments, including long and short call and put options, in an attempt to exploit a theory that public markets overestimate future market volatility. Plaintiffs do not identify any well-pled allegation in the Complaint that plausibly shows the Fund deviated from that "short-volatility" investment strategy. Under that strategy, the Fund earned profits when actual volatility was less than the level of volatility that the market had forecasted.

The Offering Materials also plainly disclosed the risks associated with the short volatility trading strategy, including the risk of large and unlimited losses. They expressly reminded investors that, during past volatility spikes, the Fund had experienced "severe immediate losses," which is precisely what occurred here. Those fully disclosed risks materialized when the VIX experienced its single largest ever spike on February 5, 2018—an undisputed historical event that Plaintiffs mischaracterize as a mere "modest spike."[1] (Opp. 7, 10, 18.) Plaintiffs' comparison of the magnitude of the Fund's losses to the limited movement in the equity markets at that time is irrelevant: as the Offering Materials explained, the Fund's performance would not be correlated to the equity markets. (Compl. ¶ 3.)

Plaintiffs' argument boils down to the following: because (1) one of the Fund's objectives was capital preservation and (2) the Fund suffered significant losses, the Offering Materials must have misstated the Fund's investment objective. This conclusory argument does not come close to satisfying the pleading standards for claims under Sections 11, 12, and 15 of the 1933 Act. Indeed, if Plaintiffs are correct that the failure of an investment objective by itself leads to a securities law violation, then the securities laws would become a form of investment insurance—because an investment fund's objectives invariably include the goal of preserving investors' capital. But courts have consistently held that the securities laws are not investment

[1] Plaintiffs allege the February 5th-6th spike was only "modest" based on a purported statement by an unidentified analyst in an unidentified source. (Compl. ¶ 68.) That statement is completely contradicted by another article Plaintiffs incorporate into the Complaint, which describes it as the "sharpest spike in history." (Ex. 4, Dkt. 151-5, at 2.) Because the Complaint quotes from and incorporates the article, the Court can consider it on a 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).

insurance.[2]

ARGUMENT

I. PLAINTIFFS FAIL TO ALLEGE ANY MATERIAL MISSTATEMENT.

A. The Offering Materials Disclosed the Fund's Trading Strategy and Risks That It Could Result in "Large," "Severe," or Even "Unlimited" Losses.

Plaintiffs' claims center on their contention that the Fund's investment objective must have been misleading because it incurred substantial losses following a "spike in volatility" in February 2018. (Opp. 10.) However, there is no actionable federal securities claim for failure to meet stated investment objectives. Rather, to assess Section 11 and Section 12 claims, courts focus on (1) what investors were told was the fund's trading strategy to accomplish the objective, (2) whether that trading strategy was actually followed, and (3) what investors were told concerning the risks associated with that strategy. *E.g.*, *In re Oppenheimer Rochester Funds Grp. Sec. Litig.*, 838 F. Supp. 2d 1148, 1162-63 (D. Colo. 2012) (cited by Plaintiffs).

That is because, as Plaintiffs acknowledge, to determine whether statements are materially misleading, courts look to "'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); *accord* Opp. 10 ("Considering the false or misleading statements in the full context in which they were made is critical. . . ."); *In re ProShares Tr. Sec. Litig.*, 728 F.3d 96, 103 (2d Cir. 2013) (affirming dismissal of complaint, stating "[i]n evaluating a prospectus, we read it as a whole. . . . As we read the prospectus cover-to-cover, we consider whether the disclosures and representations, 'taken

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[2] Plaintiffs also contend that Defendants "raise the bar for pleading by adding scienter." (Opp. 1; *see also id.* at 12.) But Defendants never mentioned "scienter."

together and in context, would have misl[ed] a reasonable investor about the nature of the [securities]'"). Here, the Offering Materials, "taken together and in context," would not have misled a reasonable investor. Contrary to Plaintiffs' efforts to dismiss them as merely "boilerplate" (Opp. 2, 15), the Offering Materials fully disclosed the Fund's trading strategy and detailed the risks associated with that trading strategy. (Defs' Mem, Dkt. 151-1 ("Mot."), 10-15.)

The Prospectus indisputably stated that the Fund's principal investment strategy was a bet against market volatility—*i.e.*, that the Fund's trading was premised on betting that the market habitually overestimated future volatility (also known as a "shorting volatility strategy"). (Compl. ¶¶ 4, 31, 36, 42, 54(f), 68; Opp. 5, 7.) The Offering Materials plainly told investors that the Fund executed its short-volatility strategy by investing in puts and calls based on the S&P, and the Offering Materials further made clear that those calls and puts included uncovered (or "naked") options.[3] (Ex. 1 at 2, 7; Compl. ¶¶ 47, 50.) There is no allegation that the Fund deviated from the short-volatility strategy articulated in the Offering Materials, or failed to trade options that those materials identified. Nor is there any allegation that the Fund invested in anything other than the derivatives described in the Offering Materials. Under this short-volatility strategy, as Plaintiffs acknowledge, the Fund "became more profitable if the market became less volatile than anticipated by the trading public." (Compl. ¶ 36.) Importantly, the Offering Materials warned that, in periods of substantial volatility spikes, the Fund could suffer "severe immediate losses." (Ex. 8 at 1, Dkt. 151-9, at 2; *see* Mot. 13.)

[3] Plaintiffs undoubtedly understood this, too, as an article quoted extensively in the Complaint expressly states that the Fund's strategy of writing naked options is well-known to amplify risk. (*See* Ex. 4 at 2.)

The Offering Materials also described in detail the "Principal Investment Risks" associated with the short volatility trading strategy that the Fund followed. (*See* Mot. 10-13.) Unable to dispute these disclosures, Plaintiffs claim, without explanation, that they were somehow "boilerplate" or "buried." (Opp. 15, 17.) Plaintiffs' claim is demonstrably false. The disclosures began on the second page of the Prospectus and were prominently labeled using a bold heading, followed by short bulleted paragraphs, each of which described a particular risk for this particular type of investment strategy. (Ex. 1 at 2.) The Prospectus also contained an additional section concerning the strategy and risks, labeled in bold, capital letters: "**ADDITIONAL INFORMATION ABOUT THE FUND'S PRINCIPAL INVESTMENT STRATEGIES AND RELATED RISKS,**" which included a distinct bold heading under which "**Principal Risk Factors**" were discussed. (*Id.* at 6-9.) The risks were "clearly and prominently highlighted for any investor merely flipping through the prospectus," and thus, any reasonable investor could not have read the Offering Materials without understanding that the Fund's short volatility trading in derivatives carried a risk of significant loss. *In re All. N. Am. Gov't Income Tr. Sec. Litig.*, 95 CIV 0330 (LMM), 1996 WL 551732, at *7 (S.D.N.Y. Sept. 27, 1996); *see also Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2, 5, 9 (2d Cir. 1996) (affirming dismissal where "detailed cautionary language of the prospectuses . . . fully disclosed the risk of investment and was specific enough to warrant a reasonable investor's attention"); *ProShares*, 728 F.3d at 102-03 (same, where "relevant prospectuses adequately warned the reasonable investor of the allegedly omitted risks"); *In re Donald J. Trump Casino Sec. Litig.-Taj Mahal Litig.*, 7 F.3d 357, 370, 376 (3d Cir. 1993) (same); Mot. 14 (collecting cases).

Plaintiffs concede that "the Fund's strategy would 'bet' against volatility," but argue that "Defendants assured the market that the Fund would not bet everything and would always have enough mitigation investment on to not place the entire investment at risk." (Opp. 5.) Tellingly, Plaintiffs cite no source in any of the Offering Materials for such "assurance"—because none exists. To the contrary, the Prospectus starkly warned that the very types of derivative instrument investments the Fund pursued could expose *the Fund* (not just a particular trade or investment) to "large" and "unlimited" losses—and that "[t]here can be no assurance that the Fund's risk mitigation strategies [would] reduce risk or [would] be either available or cost effective." (Ex. 1 at 3-4.) Defendants also disclosed to investors that, by following its stated investment strategy, the Fund could experience, and had experienced in the past, "severe immediate losses" when volatility spiked. (Ex. 8 at 1-2.) The 2015 Annual Report, which Plaintiffs quote from (Compl. ¶ 53(e)), describes specific, previous losses experienced by the Fund following a volatility spike:

> . . . In the week ending August 21st [2015], *the VIX rose 118%, marking its largest weekly gain in available data going back to 1990.* At the open on Monday, August 24th, the S&P 500 index gapped down around -5%. *The VIX hit an intraday high of over 53 representing a 90.12% spike, the largest intraday spike in the history of available intraday data (1992).*
>
> *As expected with a directional swing and volatility spike of that magnitude, the Fund experienced severe immediate losses.*

(Ex. 8 at 1-2 (emphasis added); *see* Mot. 13.)[4] Two-and-a-half years later, on February 5, 2018, the VIX experienced its "sharpest spike in history," when it "more than doubled." (Ex. 4 at 2.) This unprecedented volatility spike resulted in the losses Plaintiffs seek to recover. Seeking to downplay the extent of this unprecedented volatility spike, Plaintiffs characterize it as "modest" (Opp. 7, 10, 18), but that claim is belied by a document cited in the Complaint itself. (*See*

[4] Plaintiffs oddly complain about Defendants' citation to public disclosures in Annual Reports. (Opp. 17.) Plaintiffs themselves define "Offering Materials" to include the Annual Reports (Compl. ¶ 52).

Compl. ¶ 64 n.1 (citing article acknowledging that "[t]he VIX spike on Monday was the sharpest spike in history.").)

In short, Plaintiffs ignore the actual text of the numerous, straightforward fund-specific disclosures that warned investors of this very risk of "large," "severe," and even "unlimited" losses *to the Fund* associated with its short volatility strategy from a spike in volatility.

B. Plaintiffs Fail to Identify Any Misleading Statement.

1. The Allegations Regarding Investment Goals Are Not Actionable.

Plaintiffs' claim rests largely on the contention that the Fund "misrepresented" that one of its investment objectives was capital preservation. (Opp. 10-11.) But an "investment objective announces the goal of the Fund, rather than a promise to investors." *In re All. N. Am.*, 1996 WL 551732, at *4. Plaintiffs ignore the cases Defendants cited, which hold that investment objectives, by themselves, are not actionable. (Mot. 16.) Instead, Plaintiffs seek to convert the Fund's investment objective into a guarantee, but objectives are precisely the type of aspirational statements courts routinely find are not actionable. *E.g.*, *Tabankin v. Short*, No. 93 C 5231, 1994 WL 30541, at *5 (N.D. Ill. Feb. 1, 1994);[5] *In re All. N. Am.*, 1996 WL 551732, at *4 ("[G]eneral, forward looking statements [such as the investment objective], which make no promise to investors, are not actionable."). Plaintiffs cite other statements that discuss the Fund's "aims"

[5] Plaintiffs wrongly claim that *Tabankin* involves "much vaguer statements" than those alleged in the Complaint. (Opp. 18.) The *Tabankin* plaintiffs attacked statements regarding the fund's objective "to provide as high a level of current income as is consistent with prudent investment management," that it was "designed for the investor who seeks a higher yield than a stable money market fund," and that "in pursuing its investment objective, the Fund seeks to minimize credit risk and fluctuations. . . ." *Tabankin*, 1994 WL 30541, at *4. Those statements are analogous to those Plaintiffs attack here. In *Tabankin*, the court dismissed the claims because—as here—the complaint showed the funds "pursued the very strategies identified in the Prospectus" and "the Prospectus clearly identifie[d] the very risks that came to pass." *Id.* at *4-5. That reasoning applies equally here.

(Opp. 11), which are not actionable for the same reasons. (*See* Mot. 16-17 (collecting cases).) The Offering Materials expressly stated that an investment in the Fund "is not guaranteed to achieve its objective" and "is subject to investment risks." (Ex. 1 at 2.)

Plaintiffs contend that "Defendants engaged in speculative and aggressive trading" and used a "high-risk investment strategy" (Opp. 10-11), but Plaintiffs fail to allege a single fact to support this contention. The Offering Materials do not represent the Fund's strategy as low risk; rather, the Fund fully disclosed that its primary strategy, the purchase and sale of call and put options, entailed the risk of "large" and "unlimited" losses. And the Complaint concedes that, as stated in the Offering Materials, the Fund's strategy was to sell put and call options on S&P 500 Futures—which is precisely the trading strategy that the Fund followed. (Compl. ¶ 47.) The extensive disclosures described above (*see also* Mot. 10-13) also show that Defendants fully disclosed the specific risks associated with the strategy that the Fund followed.

Plaintiffs contend their allegations are "most analogous" to those in *Oppenheimer*. (Opp. 11, citing 838 F. Supp. 2d 1148.) Plaintiffs have misread *Oppenheimer*. In that case, the subject funds were bond funds with an investment objective to "generat[e] as much income as is 'consistent with preservation of capital'." 838 F. Supp. 2d at 1152. Consistent with the cases Defendants cite, the *Oppenheimer* court noted that a statement regarding the investment objective, "standing alone, would not be one that 'a reasonable investor would consider important in deciding whether or not to invest'." *Id.* at 1161, 1162 (discussing *TCW/DW N. Am. Gov't Income Tr. Sec. Litig.*, 941 F. Supp. 326, 338-39 (S.D.N.Y. 1996)). The court then analyzed whether the fund had followed its disclosed trading strategy and whether the offering materials disclosed the risks associated with that trading strategy. *Id.* at 1163.

Ultimately, the *Oppenheimer* court denied the motion to dismiss, finding plaintiffs alleged that the defendants had not adequately disclosed risk associated with "inverse floaters" that were part of the fund's investment strategy. 838 F. Supp. 2d at 1165 (each prospectus stated that inverse floaters "can be" more volatile than conventional fixed-rate securities, but by definition they are "'*always*' more volatile because they move at a multiple of whatever rate a fixed rate security moves") (emphasis added). By contrast, Plaintiffs alleged no facts to show that the Fund failed to follow the strategy it disclosed or failed to disclose risks associated with the strategy it followed or any investment made as part of that strategy.

Plaintiffs' citation to *In re Evergreen Ultra Short Opportunities Fund Sec.* also misses the mark. (Opp. 11-12, citing 705 F. Supp. 2d 86, 92 (D. Mass. 2010).) That court also held that the investment objective, read alone, was not actionable, but sustained the allegations because the plaintiff alleged facts showing the fund failed to follow its stated strategy. 705 F. Supp. 2d at 92 (holding that "the basic claim that the Fund sought to 'provide income consistent with preservation of capital and low principal fluctuation'" was too "general and indefinite" to be actionable, but that alleged misstatements concerning "distinct claims about the posture of the Fund, its investment strategies and the rules under which it would operate" were actionable). For example, contrary to the fund's statement that its investment strategy included "maintain[ing] an average portfolio duration of one year or less," the plaintiff alleged plausible facts showing that the fund's "average portfolio duration exceeded one year." *Id.* at 92, 95. In stark contrast, the Complaint in this case does not allege any deviation from the Fund's stated investment strategy, the purchase or sale of an undisclosed security, or a failure to disclose the risks associated with the strategy it followed. Rather, Plaintiffs make only conclusory assertions that they must have a claim because the Fund incurred losses.

If Plaintiffs' allegations were sufficient, then every investor who suffered losses would have a viable claim under the securities laws. But courts are clear that the securities laws are not investment insurance. (*See* Mot. 15 (collecting cases)); *see also generally Searls v. Glasser*, 64 F.3d 1061, 1069 (7th Cir. 1995) ("The federal securities laws should not be mistaken for insurance against risky investments; the federal reporters are replete with failed attempts to do just that."); *Malack v. BDO Seidman, LLP*, 617 F.3d 743, 752 (3d Cir. 2010) (similar).

2. <u>The Allegations Regarding the Fund's Risk Mitigation Techniques Are Not Actionable.</u>

Plaintiffs also contend that statements in the Offering Materials regarding the Fund's risk management and risk mitigation techniques were misleading (Opp. 13). Once again, Plaintiffs point to no well-pled facts that the Fund failed to follow any risk mitigation techniques described in the Offering Materials. Absent such facts, no claim can be stated. Moreover, the Offering Materials expressly warned that "there can be no assurance that the Fund's risk mitigation strategies [would] reduce risk or [would] be either available or cost effective." (Ex. 1 at 3.)

At bottom, Plaintiffs' assertion that the "Fund lacked adequate risk controls" (Opp. 13) amounts to nothing more than a claim for mismanagement or breach of fiduciary duty. But it is "well-established that the securities laws do not create liability for breaches of fiduciary duty or mismanagement." *In re Donald J. Trump*, 7 F.3d at 376; *see also Singh v. Cigna Corp.*, No. 17-3484-cv, 2019 WL 1029597, at *1 (2d Cir. Mar. 5, 2019) (in Rule 10b-5 action, rejecting plaintiffs' attempt to "recast corporate mismanagement as securities fraud" because alleged misstatements were not materially misleading). Plaintiffs' citation to *Hunt v. Alliance N. Am Gov't Income Trust, Inc.*, is not to the contrary. (Opp. 14, citing 159 F.3d 723, 729 (2d Cir. 1998).) It stands only for the unremarkable proposition that disclosures do not foreclose liability where they warn of a different contingency than that which a plaintiff alleges was misrepresented.

3. The Allegations Regarding the Fund's Past Performance Are Not Actionable.

Plaintiffs concede that accurate statements regarding past performance are not actionable. (Opp. 14.) Although Plaintiffs make the conclusory assertion that Defendants omitted material information concerning past performance (*id.* at 14-15), they failed to allege any facts showing that any historical information was misleading. Instead, Plaintiffs copied statements from Annual Reports, which merely summarized the prior year's performance, and ignored the warning in the Prospectus that past performance "may not be an indication of how the Fund will perform in the future." (Exs. 3, 7-9; Ex. 1 at 4.)

C. Plaintiffs' Other Attempts to Discount the Offering Materials' Disclosures Fail.

Plaintiffs' remaining arguments are meritless. *First*, Plaintiffs attempt to limit the risk disclosures to warning of losses from "singular" transactions, rather than losses to the Fund itself (Opp. 15), but that assertion mischaracterizes the actual disclosures and simply makes no sense. The Offering Materials *did* warn of potentially "large" and "unlimited" losses *to the Fund*. (*Id.* at 16; *see* Ex. 1 at 4 ("*The Fund's losses are potentially large* in a written put transaction *and potentially unlimited* in a written call transaction.") (emphasis added); *id.* at 3 ("It is possible that *moderate changes in the S&P Futures Index can lead to large losses* in the derivatives held by the Fund") (emphasis added).) Plaintiffs argue that those warnings were insufficient because they discussed losses only in the context of "derivatives" or "transactions" (Opp. 16), but "derivatives" were precisely the type of instruments in which the Fund was investing, as disclosed in the Offering Materials. In fact, Plaintiffs nowhere point to any disclosure that suggests that the Fund would make any investment apart from derivatives. Moreover, Plaintiffs' distinction between "individual losses" and losses to the "entire Fund" is meaningless. The Offering Materials expressly warned that *the Fund* could experience "large" and even "unlimited" losses from its disclosed investment strategy. (Ex. 1 at 4; *see* Mot. 13.) Significant fund-wide losses had occurred in 2015 following an earlier, though smaller, volatility spike, and the Offering Materials reminded investors of that fact and advised them that it could recur.

Plaintiffs similarly argue that the Fund's disclosures did not include that "large losses [were] foreseeable and inevitable." (Opp. 16-17.) However, the Complaint does not allege that losses were "inevitable." Investors were warned that large losses were possible: the Offering Materials stated, "[you] may lose part *or all* of your investment in the [F]und" and that the "Fund's losses are potentially *large* . . . and . . . *unlimited*." (Ex. 1 at 2, 4 (emphasis added).) What happened here is that these large losses occurred—as warned—when the VIX experienced a significant spike.

The cases Plaintiffs cite do not support their argument that the Fund's disclosures were inadequate. (Opp. 17, citing *Pommer v. Medtest Corp.*, 961 F.2d 620 (7th Cir. 1992), *Shah v. Zimmer Biomet Holdings*, 348 F. Supp. 3d 821 (N.D. Ind. 2018), and *In re Oppenheimer Rochester Funds Grp. Sec. Litig.*, 838 F. Supp. 2d 1148 (D. Colo. 2012).) In each, the court found that the defendants had attempted to rely on disclosures that did not relate to the alleged misrepresentations. *See Oppenheimer*, 838 F. Supp. 2d at 1167-68; *Shah*, 348 F. Supp. 3d at 842; *Pommer*, 961 F.2d at 624-25. Here, by contrast, the Fund's disclosures fully and adequately address each of Plaintiffs' conclusory allegations; indeed, the Fund disclosed the precise short volatility strategy that was followed, and the risk of "unlimited" losses to the Fund from that strategy. Plaintiffs nowhere state facts regarding how the Fund supposedly failed to follow that strategy.

Second, Plaintiffs argue that the sufficiency of risk disclosures cannot be decided on a motion to dismiss. (Opp. 16.) However, courts routinely dismiss Section 11 and Section 12 claims at the pleading stage based on the content of disclosures. (*See* Mot. 14 (collecting cases).)

Third, Plaintiffs' allegations that Defendants violated Items 303 and 503 of Regulation S-K do not support their claims. Defendants explained that the extensive disclosures in the Offering Materials show that Defendants did not violate Items 303 or 503. (Mot. 13, n.7.) While Plaintiffs claim that Defendants somehow waived these arguments (Opp. 19), Defendants addressed Items 303 and 503 by expressly incorporating (rather than repeating) earlier arguments regarding extensive disclosures (Mot. 13, n.7). Where, as here, arguments are sufficiently developed, courts do not find waiver. *See, e.g., Vita Food Prods., Inc. v. Navigators Ins. Co.*, No. 16 C 08210, 2017 WL 2404981, at *5 n.2 (N.D. Ill. June 2, 2017) (finding argument presented in footnote was sufficiently developed so was not waived); *Arnold v. Cty. of Cook*, 220 F. Supp. 2d 893, 898 n.4 (N.D. Ill. 2002) (same).

II. PLAINTIFFS FAIL TO ALLEGE LOSS CAUSATION.

Plaintiffs concede that, where it is apparent from the face of a complaint that there is no loss causation, Section 11 or Section 12(a)(2) claims should be dismissed. (Opp. 20; Mot. 19.)

Plaintiffs argue, however, that they have pled loss causation simply because they assert that "Defendants' misstatements concealed the Fund's overexposure to the risk of volatility and failure to engage in risk mitigation." (Opp. 20.) Plaintiffs' argument makes no connection to the Fund's *value*—which is the relevant inquiry for loss causation. Both Section 11 and Section 12 give rise to liability only for "the *depreciation in value* of such security resulting from such part of the alleged misstatement [in the registration statement or prospectus] not being true or omitting to state a material fact . . . ." 15 U.S.C. 77k(e), 77l(b) (emphasis added). Because a mutual fund's NAV is merely a composite value of the instruments held in the portfolio, which is statutorily-defined (Mot. 20), the NAV cannot be affected by any alleged misstatement or omission in the Offering Materials.[6] *See In re State St. Bank & Trust Co. Fixed Income Funds Inv. Litig.*, 774 F. Supp. 2d 584, 590-91 (S.D.N.Y. 2011).

Plaintiffs cite cases that analyze a fund's "value" as something other than "NAV." (Opp. 20-21.) In those cases, loss causation was found to be adequately alleged where plaintiffs pleaded facts that the NAV itself was misrepresented or that the fund's "value" was affected by a specific factor that was not necessarily accounted for in the fund's NAV—neither of which Plaintiffs allege here. For example, in *Oppenheimer*, the court held that loss causation was sufficiently alleged because the plaintiffs had alleged that the defendants had improperly inflated the NAV of the funds by underrepresenting the percentage of illiquid assets the portfolio held. 838 F. Supp. 2d at 1152, 1171. And in *Youngers v. Virtus Inv. Partners, Inc.*, the court found loss causation was adequately pleaded where plaintiffs alleged a misrepresentation concerning the fund's performance history, which affected its value. (Opp. 20-21, citing 195 F. Supp. 3d 499, 512 (S.D.N.Y. 2016).) More specifically, the plaintiffs in *Youngers* alleged that the defendant had failed to disclose that the historical performance was the result of back-testing, rather than actual performance. 195 F. Supp. 3d at 512. Because the plaintiffs in *Youngers* had

[6] Plaintiffs repeatedly claim that the Fund was "overexposed." (Opp. 3, 5, 13, 16, 19.) But Plaintiffs never explain what "overexposed" means, or how being "overexposed" is inconsistent with the disclosures. At bottom, this is a criticism (with benefit of hindsight) of the investment strategy, not an actionable securities claim that investors were misled by disclosures that inflated the Fund's NAV.

alleged that the statements regarding historical performance could have artificially inflated the fund's value, the court denied the motion to dismiss based on a lack of loss causation. *Id.*

Here, by contrast, Plaintiffs nowhere allege that any alleged misrepresentation inflated the NAV or the Fund's value at any time. Nor do Plaintiffs allege that the Fund's NAV failed to reflect the true market prices of any assets the Fund owned. Absent such facts, Plaintiffs have not pleaded that any misrepresentation affected the Fund's value. Accordingly, the Complaint shows that loss causation cannot be established.[7]

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

Each Defendant has shown that the Section 12(a)(2) claim should be dismissed because Plaintiffs fail to allege facts demonstrating that any Defendant sold securities to Plaintiffs or actively solicited Plaintiffs' purchase. (Mot. 21-22 (collecting cases).) Plaintiffs respond with the conclusory claim that Defendants "participated in the preparation of the false and misleading Offering Materials" and "in marketing the Fund to investors" (Opp. 22). This argument falls well short of stating a claim because it lacks any factual detail as to any individual defendant's actions. Fed. R. Civ. P. 8(a); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555–56 (2007).

As to the Trustee Defendants, Plaintiffs argue that those defendants signed the registration statement. (Opp. 22-23.) While Plaintiffs recognize that the Seventh Circuit has not addressed whether merely signing a registration statement renders someone a statutory seller,

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[7] Other courts have similarly sustained claims where plaintiffs alleged (unlike here) that the NAV was improperly calculated and thus misrepresented. *See*, *e.g.*, *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC*, 595 F.3d 86, 96 (2d Cir. 2010) (loss causation adequately pled where transfer agent fees were improperly deducted from the mutual funds' assets in calculating its NAV); *In re AIG Advisor Grp.*, No. 06 CV 1625(JG), 2007 WL 1213395, *11 (E.D.N.Y. Apr. 25, 2007) (where mutual fund improperly paid fees, thereby improperly diminishing the fund's performance). There are no such allegations here.

they fail to acknowledge that "[e]very 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)." *Citiline Holdings, Inc. v. iStar Fin. Inc.*, 701 F. Supp. 2d 506, 512 (S.D.N.Y. 2010) (citing *Rosenzweig v. Azurix Corp*., 332 F.3d 854, 871 (5th Cir. 2003)); *Shaw v. Digital Equip. Corp*., 82 F.3d 1194, 1216 (1st Cir. 1996); *Craftmatic Sec. Litig v. Kraftsow*, 890 F.3d 628, 636 (3d Cir. 1989); *see also e.g., Xiang v. Inovalon Holdings*, 245 F. Supp. 3d 635, 645 (S.D.N.Y. 2017); *City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.*, 928 F. Supp. 2d 705, 720 (S.D.N.Y. 2013). Nor are the Trustee Defendants statutory sellers merely because they were trustees or officers of the Trust. *See Starr v. !Hey, Inc.*, No. 01 C 6087, 2003 WL 21212596, at *4 (N.D. Ill. May 23, 2003) (dismissing Section 12 claims where complaint alleged defendants "solicited" purchases by virtue of their positions within the company but failed to allege any contact between plaintiff and defendants); *Maton v. Arthur Andersen & Co.*, No. 91 C 1885, 1991 WL 131184, at *3 (N.D. Ill. July 5, 1991) (finding defendants "are not statutory sellers merely because they are allegedly officers or directors" of the company). Finally, Plaintiffs have not alleged a single fact suggestion that the Trustee Defendants (or Trust Officers) did anything more than simply sign the Registration Statements. Plaintiffs' failure to allege any specific action taken by any Trustee or Trust Officer that would make him or her a statutory seller renders their Section 12(a) claims unsustainable.

In addition to the arguments raised in connection with other defendants, Plaintiffs' Section 12(a) claim against NLD fails because Plaintiffs do not dispute that the Underwriting Agreement states that NLD had no responsibility for alleged misstatements in the Offering Materials regarding the Fund's strategy or performance. (Mot. 23-24.) Instead, Plaintiffs argue that it would be inappropriate to consider the Underwriting Agreement on a motion to dismiss

(Opp. 23)—which makes little sense given Plaintiffs' admission that the publicly available document is referenced in the Complaint (*id.* n.10). Accordingly, the Court may properly consider the Underwriting Agreement on this Motion. (*See* Mot. 24 n.9 (citing cases).)

Plaintiffs also argue that NLD is a statutory seller because the Statement of Additional Information stated that it would "use reasonable efforts to facilitate the sale of the Fund's shares." (Opp. 24.) That statement says nothing about what actions NLD itself *actually took*—which is the salient inquiry—and Plaintiffs have alleged no facts concerning any action NLD itself took to "facilitate the sale of the Fund's shares" or any contact between NLD and Plaintiffs. Absent such facts, Plaintiffs have failed to allege that NLD "actively solicited" the purchase. And Plaintiffs fail to point to any actions that NorthStar, NLD's purported "control person," took to sell or solicit sales of Fund.

Without citing to any authority, Plaintiffs argue Defendants waived their arguments that Caine and Parvataneni were not statutory sellers. (Opp. 22, n.9.) Plaintiffs are wrong. There is no wavier, because in their motion Defendants explained that Plaintiffs failed to specify any conduct particular to Caine and Parvataneni, and thus they failed to satisfy the requirements for Section 12(a)(2). (Mot. 22.) To establish "solicitation" for Section 12, Plaintiffs must allege not only that the defendants actively solicited investors, but also that Plaintiffs themselves purchased the securities as a result of that solicitation. *Steed Fin. LDC v. Nomura Sec. Int'l, Inc.*, No. 00 CIV. 8058(NRB), 2001 WL 1111508, at *7 (S.D.N.Y. Sept. 20, 2001). The Complaint never alleges that any Plaintiff, much less the entire class, purchased shares in the Fund based on Caine's or Parvataneni's alleged statements in promotional materials—but instead merely alleges Caine and Parvataneni were "featured and quoted in promotional materials" without even identifying any of those materials. (Comp. ¶¶ 26-27.)

Accordingly, Plaintiffs have not stated a Section 12 claim as to any defendant. *See Pinter v. Dahl*, 486 U.S. 622, 650 (1988); *Starr*, 2003 WL 21212596, at *4.

IV. PLAINTIFFS' SECTION 15 CLAIMS ARE INSUFFICIENT.

Plaintiffs' arguments concerning their control person claims are unavailing. Plaintiffs concede, as they must, that the Trustee Defendants' status alone is insufficient to establish Section 15 liability. Instead, Plaintiffs argue they "alleged more than simply the status of the Individual Defendants[,]" pointing to allegations that the Trustee Defendants: (1) signed the 2015 – 2017 Registration Statements; (2) participated in the process where the shares were sold; and (3) had the power and responsibility to oversee the Trust's business. (Opp. 26; Compl. ¶¶ 20-25, 28, 96). However, Plaintiffs fail to demonstrate control person liability contemplated by Section 15. As an initial matter, "[s]ignatures are one factor supporting a control allegation, but [P]laintiffs must show signatures plus other indicia of control." *In re Lernout & Hauspie Sec. Litig.*, 286 B.R. 33, 43 (D. Mass. 2002) (citations omitted). Here, Plaintiffs' remaining two allegations—that the Trustee Defendants participated in the process and oversaw the Trust's business—do not contain indicia of control. Rather, those allegations merely define the Trustee Defendants' *status* by detailing their responsibilities as trustees. This is insufficient. Plaintiffs cannot satisfy their burden to demonstrate control by pleading a boilerplate, dictionary definition of "trustee." *See Starr*, 2003 WL 21212596, at *4 (holding that "[c]ourts within this District have consistently held that a plaintiff may not premise control person liability solely upon status within the company") (citations omitted). As to the other Individual Defendants, Plaintiffs only point to a vague allegation of them collectively "having otherwise participated in the process that allowed the sale of the shares of the Fund" (Opp. 26; Compl. ¶ 26), which is insufficient.

Plaintiffs' control person arguments against NorthStar are also fatally defective.

Plaintiffs cannot point to any factual allegation showing that NorthStar "actually participated in the process" through which Fund shares were sold, or was "primarily responsible for the day-to-day management" of the Fund or NLD, or had "responsibility for overseeing . . . risk management" of the Fund or NLD, or was "featured and quoted in promotional materials" for the Fund or NLD. (Opp. 26.)[8]

Plaintiffs argue that some courts have found meager allegations such as the ones they level at NorthStar sufficient to state a control person liability claim. (Opp. 27.) However, the only case they cite, *Oppenheimer*, 838 F. Supp. 20 at 1181, is a case from the District of Colorado that specifically points out that the Tenth Circuit applies a more liberal pleading standard for control person liability than other circuits. *See also Maher v. Durango Metals, Inc.*, 144 F.3d 1302, 1305 (10th Cir. 1998) (explaining the 10th Circuit has "expressly 'reject[ed]'" more stringent pleading standards for control person liability applied by other circuits) (cited with approval in *Oppenheimer*). Moreover, even *Oppenheimer* stated that "corporate status" is insufficient to support an inference of control person liability unless it "relates directly to the underlying (primary) violation," such as allegations that the officers of the alleged control person entity "oversaw the preparation and content of the [allegedly misleading] Fund offering statement." 838 F. Supp. 2d at 1183. Plaintiffs do not allege that NorthStar officers oversaw the preparation of the allegedly misleading Offering Materials here.

As for Caine and Parvataneni, Plaintiffs point only to their bare allegation they were "featured and quoted in promotional materials" they are not alleged to have written. (Opp.

[8] To the extent Plaintiffs allege that signing the Registration Statements is relevant to control person status (Opp. 26), neither NorthStar nor NLD—which Plaintiffs allege NorthStar controlled—even signed the Registration Statement.

26.) This hardly establishes "majority control" or "an active role in the day-to-day operations of the business."

V. PLAINTIFFS' CLAIMS ARE TIME-BARRED.

Plaintiffs do not dispute that the Fund disclosed its specific holdings in its Annual Reports, including in a report from 2015. Those disclosures stated the specific options the Fund was holding, which were entirely consistent with the Fund's stated investment strategy. Given Plaintiffs' contention that the Fund somehow was not following its disclosed strategy, Plaintiffs should have discovered that at least by 2015, when they received the Annual Reports disclosing the options the Fund was holding. Because Plaintiffs brought the claim more than one year after they could have discovered their claims, their claims are time-barred.

CONCLUSION

For the foregoing reasons, and those stated in their opening memorandum of law, Defendants respectfully request that the Court enter an order dismissing the Complaint in its entirety and with prejudice.

Dated: March 25, 2019 Respectfully submitted,

MARK GARBIN, MARK D. GERSTEN, NEIL M. KAUFMAN and ANITA K. KRUG By: /s/ *Evan H. Lechtman* One of their Attorneys Evan H. Lechtman (admitted *pro hac vice*) Charles Fitzpatrick IV(admitted *pro hac vice*) BLANK ROME 130 North 18th Street Philadelphia, Pennsylvania 19103 Phone: (215) 569-5367 Fax: (215) 832-5367 Daniel R. Fine	TWO ROADS SHARED TRUST, ANDREW B. ROGERS and JAMES COLANTINO By: /s/ *Bradley J. Andreozzi* One of their Attorneys Bradley J. Andreozzi Daniel J. Delaney DRINKER BIDDLE & REATH LLP 191 N. Wacker Drive, Suite 3700 Chicago, Illinois 60606 Phone: (312) 569-1175 Fax: (312) 569-3175

BARRACK FERRAZZANO KIRSCHBAUM & NAGELBERG LLP 200 W. Madison Street, Suite 3900 Chicago, Illinois 60606 Phone: (312) 985-3100	
LJM FUNDS MANAGEMENT, LTD, ANTHONY J. CAINE, and ANISH PARVATANENI By: /s/ *Peter G. Rush* One of their Attorneys Peter G. Rush Jeffry M. Henderson Steven M. Malina GREENBERG TRAURIG, LLP 77 West Wacker Drive, Suite 3100 Chicago, Illinois 60601 Phone: (312) 456-8400	NORTHERN LIGHTS DISTRIBUTORS, LLC AND NORTHSTAR FINANCIAL SERVICES GROUP, LLC By: /s/ *Thomas K. Cauley, Jr.* One of their attorneys Thomas K. Cauley, Jr. Ashley K. Martin SIDLEY AUSTIN LLP One South Dearborn Street Chicago, Illinois 60603 Phone: (312) 853-7000 Fax: (312) 853-7036 Alex J. Kaplan (admitted *pro hac vice*) Deborah Sands (*pro hac vice* pending) SIDLEY AUSTIN LLP 787 Seventh Avenue New York, New York 10019 Phone: (212) 839-5300 Fax: (212) 839-5599
NORTHSTAR FINANCIAL SERVICES GROUP, LLC By: */s/ Daniel P. Roeser* One of their attorneys Daniel P. Roeser Mark Holland (admitted *pro hac vice*) GOODWIN PROCTER LLP The New York Times Building 620 Eighth Avenue New York, NY 10018 Phone: (212) 813-8800 Fax: (212) 355-3333 Roberto M. Braceras (admitted *pro hac vice*)	

GOODWIN PROCTER LLP 100 Northern Avenue Boston, MA 02210 Phone: (617) 570-1000 Fax: (617) 523-1231	

CERTIFICATE OF SERVICE

I, Ashley K. Martin, hereby certify that on March 25, 2019, I electronically filed the foregoing Defendants' Reply In Further Support of Their Joint Motion to Dismiss the Consolidated Complaint using the CM/ECF system, which will send notices to all counsel of record in this proceeding.

/s/ Ashley K. Martin
Ashley K. Martin