

1 UNITED STATES DISTRICT COURT  
2 EASTERN DISTRICT OF WASHINGTON

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5 No. CV-04-25-FVS

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7 In re METROPOLITAN SECURITIES  
8 LITIGATION

9 ORDER GRANTING AND  
10 DENYING ROTH CAPITAL  
11 PARTNERS' MOTION FOR  
12 SUMMARY JUDGMENT

13 **THIS MATTER** came before the Court for oral argument on January 5,  
14 2010, based upon Roth Capital Partners' motion for summary judgment.

15 **BACKGROUND**

16 Metropolitan Mortgage & Securities Co., Inc., ("Met"), and Summit  
17 Securities, Inc. ("Summit") sold securities through Metropolitan  
18 Investment Securities, Inc. ("MIS"). MIS was governed by the rules  
19 established by the National Association of Securities Dealers  
20 ("NASD"). Since MIS was a wholly-owned subsidiary of Summit, and  
21 since it was affiliated with Met, MIS had to hire a qualified  
22 independent underwriter ("QIU") to recommend the maximum offering  
23 price for equity securities or the minimum yield for debt securities.  
24 MIS retained Roth Capital Partners, LLC, ("Roth") to serve as its QIU.  
25 In that capacity, Roth participated in the preparation of a number of  
26 registration statements Met and Summit filed with the Securities and  
Exchange Commission ("SEC"). The plaintiffs purchased securities

1 pursuant to four registration statements with respect to which Roth  
2 served as the QIU. By the end of 2003, the securities had lost all,  
3 or nearly all, of their value. The plaintiffs filed an action during  
4 January of 2004. They seek damages from Roth under § 11 of the  
5 Securities Act of 1933. 15 U.S.C. § 77k(a). Roth moves for summary  
6 judgment on a number of issues.

### 7 **MISSTATEMENTS AND/OR OMISSIONS**

8 The plaintiffs allege the offering materials contain multiple  
9 misstatements and/or omissions. Roth argues it may not be held liable  
10 for five of them. One alleged misstatement and/or omission is located  
11 in a section of a prospectus that is entitled "RISK FACTORS." The  
12 plaintiffs challenge the accuracy of the following statement, "We will  
13 rely, in part, on our subsidiaries to make payments to us in order for  
14 us to make payments on the certificates." A second alleged  
15 misstatement and/or omission is located in a section of a prospectus  
16 that is entitled "USE OF PROCEEDS." The plaintiffs challenge the  
17 prospectus' description of the manner in which the proceeds of the  
18 offering will be used by Met and Summit. A third alleged misstatement  
19 and/or omission is located in a section of a prospectus that is  
20 entitled "PLAN OF DISTRIBUTION." The plaintiffs challenge the  
21 accuracy of the following statement, "[S]ales will only be made in  
22 compliance with the suitability standards listed in Rule 2720 of the  
23 NASD Conduct Rules." A fourth alleged misstatement and/or omission is  
24 located in a Form 10-K. The plaintiffs allege it failed to disclose  
25 the existence of a lawsuit. A fifth alleged misstatement and/or  
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1 omission is located in a Met registration statement that was filed on  
2 March 27, 2003. The plaintiffs challenge the accuracy of the  
3 following statement, "If MIS is unable to continue selling our"  
4 securities, "our business would be harmed."

5 The plaintiffs deny they are conceding summary judgment with  
6 respect to any of the alleged misstatements and/or omissions listed  
7 above. Nevertheless, they have not discussed the third, fourth or  
8 fifth alleged misstatements and/or omissions. Their silence is  
9 dispositive. If a nonmoving party fails to produce enough evidence to  
10 create a genuine issue of material fact, the moving party is entitled  
11 to summary judgment. See *Nissan Fire & Marine Ins. Co., Ltd. v. Fritz*  
12 *Companies, Inc.*, 210 F.3d 1099, 1103 (9th Cir.2000) (hereinafter  
13 "*Nissan Fire & Marine*"). Roth is entitled to summary judgment with  
14 respect to the third, fourth and fifth alleged misstatements and/or  
15 omissions.<sup>1</sup>

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17 What about the first and second alleged misstatements and/or

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19 <sup>1</sup>Nor is there much the plaintiffs could have said concerning  
20 the fourth and fifth alleged misstatements and/or omissions. As  
21 for the fourth, Summit disclosed the existence of the lawsuit in  
22 a section that is entitled "SERVICING, COLLECTION AND DELINQUENCY  
23 EXPERIENCE." The next to the last sentence in the last paragraph  
24 states, "In August of 2001, Summit filed litigation against  
25 [Hawaii Forest Preservation LLC] and related parties in the State  
26 of Hawaii where Summit seeks recovery of amounts due under the  
Timber Harvesting Agreement." As for the fifth alleged  
misstatement and/or omission, the plaintiffs appear to concede  
the March 27, 2003, registration statement does not fall within  
the scope of their § 11 claim against Roth.

1 omissions? Roth argues it is entitled to protection under the "safe  
2 harbor" provisions of the Private Securities Litigation Reform Act of  
3 1995 ("PSLRA"), Pub.L. No. 104-67, 109 Stat. 743 (1995). The PSLRA  
4 shelters "forward looking statements" in certain situations. 15  
5 U.S.C. § 77z-2(c)(1). By way of example, Roth may not be held liable  
6 for a forward looking statement that is accompanied by "meaningful  
7 cautionary statements identifying important factors that could cause  
8 actual results to differ materially from those in the forward-looking  
9 statements[.]" 15 U.S.C. § 77z-2(c)(1)(A)(i). Again by way of  
10 example, Roth may not be held liable for a forward looking statement  
11 if the plaintiffs fail to demonstrate the statement was made or  
12 approved by an executive officer with actual knowledge the statement  
13 was false or misleading. See 15 U.S.C. § 77z-2(c)(1)(B)(ii).

14 As explained above, the first alleged misstatement and/or  
15 omission is located in the "RISK FACTORS" section of a prospectus. It  
16 says, "We will rely, in part, on our subsidiaries to make payments to  
17 us in order for us to make payments on the certificates." The  
18 plaintiffs allege the statement is false because Met's and Summit's  
19 insurance subsidiaries were barred by law from making "upstream"  
20 payments. In evaluating the plaintiffs' allegation, the first thing  
21 to note is the disputed statement sets forth Met's and Summit's plan  
22 to receive payments from their insurance subsidiaries in the future.  
23 "[P]lans and objectives . . . for future operations" are forward  
24 looking statements. 15 U.S.C. § 77z-2(i)(1)(B). Pre-PSLRA cases held  
25 an underwriter may seek protection for forward looking statements. In  
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1 *re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1415-21 (9th Cir.1994)  
2 (extending the "bespeaks caution" doctrine, which was codified by the  
3 PSLRA, to an underwriter). There is nothing in the PSLRA indicating  
4 Congress intended to modify this rule. Consequently, Roth is entitled  
5 to summary judgment if it demonstrates the above-quoted sentence is  
6 accompanied by meaningful cautionary statements or if the plaintiffs  
7 fail to demonstrate an executive officer approved the sentence with  
8 actual knowledge it was false.

9 The text following the disputed sentence contains cautionary  
10 language. "To use money for dividends, these insurance companies must  
11 obtain permission from the insurance commission in their state of  
12 domicile. If our subsidiaries stopped making payments to us, we may  
13 be unable to pay the full amounts owed to you on the certificates."  
14 The plaintiffs argue the preceding statements were insufficiently  
15 cautionary. According to the plaintiffs, it would have been difficult  
16 for the insurance subsidiaries to obtain permission to make payments  
17 to their parent companies and, even if they had obtained permission,  
18 the amount of money they could have paid would have been minimal in  
19 view of insurance regulations limiting such payments. The Court  
20 assumes the plaintiffs' factual allegations are true. Even so, it is  
21 questionable whether a rational jury could find the disputed language  
22 was inadequate. The prospectus provides no assurance state regulators  
23 will authorize the insurance subsidiaries to make "upstream" payments  
24 to Met and Summit; this despite informing potential investors such  
25 authorization is required. Nevertheless, assuming a rational jury  
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1 could find the disputed language was inadequate, the plaintiffs must  
2 demonstrate an executive officer approved the disputed language  
3 knowing it was false. The plaintiffs argue a rational jury could draw  
4 such an inference from the record. They cite interviews of Met's and  
5 Summit's officers. Although the notes of the interviews are difficult  
6 to read, they seem to suggest the officers were aware the insurance  
7 subsidiaries were closely regulated. Given the officers' awareness,  
8 say the plaintiffs, a rational jury could infer they knew the disputed  
9 language was false. The problem with the plaintiffs' position is  
10 this: It is one thing to demonstrate the officers knew the insurance  
11 subsidiaries were closely regulated; quite another thing to  
12 demonstrate they knew the subsidiaries would not be able to make  
13 significant payments to their parent companies. The plaintiffs have  
14 submitted a declaration from C. Paul Sandifur, Jr. He owned or  
15 controlled the common stock of both Met and Summit, and he played a  
16 pivotal role in the events that led to the companies' demise. There  
17 is nothing in his declaration from which a rational jury could infer  
18 he knew the insurance subsidiaries could not make the payments  
19 described in the prospectus. Absent such evidence (or something like  
20 it), the inference requested by the plaintiffs is unwarranted. A  
21 rational jury would be unable to find the officers who approved the  
22 disputed language knew it was false.

24 The second of the five alleged misstatements and/or omissions is  
25 located in a section that is entitled "USE OF PROCEEDS." In essence,  
26 the registration statement claimed 80% of the proceeds would be used

1 to fund new investments and 20% of the proceeds would be used to  
2 develop real estate the companies held or acquired. The plaintiffs  
3 allege those representations were false. In the plaintiffs' opinion,  
4 Met and Summit had to sell securities in order to stay in business.  
5 This allegation is supported by Mr. Sandifur's declaration. Thus,  
6 were the 80%/20% statement the only statement concerning the use of  
7 proceeds, the plaintiffs would have a compelling argument; but, as  
8 Roth points out, the "USE OF PROCEEDS" section contains cautionary  
9 language. "To the extent internally generated funds are insufficient  
10 or unavailable, proceeds of this offering may be used for retiring  
11 maturing investment debentures and notes, preferred stock dividends  
12 and for general corporate purposes, including debt service and other  
13 general operating expenses." The preceding statement provided a  
14 meaningful warning to potential investors. In light of the warning,  
15 investors had notice that proceeds might be applied in a manner other  
16 than the 80%/20% split set forth in the section.  
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18 In sum, Roth is entitled to summary judgment on all five  
19 statements listed above. Insofar as the first statement is concerned  
20 (*i.e.*, "will rely"), it is because a rational jury would be unable to  
21 find the officer who approved the language knew it was false. Insofar  
22 as the second statement is concerned (*i.e.*, "use of proceeds"), it is  
23 because a rational jury would be unable to find it lacked meaningful  
24 cautionary language. Insofar as the third, fourth and fifth  
25 statements are concerned, it is because the plaintiffs did not attempt  
26 to establish the existence of genuine issues of material fact.

1 Consequently, the plaintiffs may not obtain damages from Roth based  
2 upon the statements listed above.

3 **"EXPERTISED" PORTIONS OF REGISTRATION STATEMENTS**

4 An underwriter may not be held liable for those parts of a  
5 registration statement whose accuracy has been certified by an  
6 accountant -- *i.e.*, the "expertised" parts of the registration  
7 statement -- if the underwriter "'had no reasonable ground to believe,  
8 and did not believe . . . that the statements therein were untrue or  
9 that there was an omission to state a material fact required to be  
10 stated therein or necessary to make the statements therein not  
11 misleading.'" *In re Software Toolworks Inc.*, 50 F.3d 615, 623 (9th  
12 Cir.1994) (quoting 15 U.S.C. § 77k(b)(3)(C)). The plaintiffs  
13 acknowledge the rule, but submit Roth's purported reliance upon PwC's  
14 and E&Y's accounting determinations was unjustified because Roth was  
15 confronted with "red flags" indicating PwC's and E&Y's calculations  
16 were incorrect. By way of example, the plaintiffs cite the  
17 accountants' determinations regarding a tax shelter named the "Foreign  
18 Leveraged Investment Program" ("FLIP"). The plaintiffs argue Roth  
19 should have questioned PwC's and E&Y's determinations. For one thing,  
20 there was the sheer magnitude of the transaction. According to the  
21 plaintiffs, the benefits associated with FLIP constituted 75% of Met's  
22 income during Fiscal Year ("FY") 1999. For another thing, Met's  
23 reliance upon the transaction posed troubling questions about the  
24 company's future profitability. According to the plaintiffs, Met  
25 would have had to generate 80 million dollars in future profits in  
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1 order to take advantage of FLIP. In response, Roth insists the  
2 plaintiffs have misstated the nature of a "red flag." Contrary to the  
3 plaintiffs' contention, a red flag is not a circumstance that would  
4 cause one expert to question another expert's determinations. Rather,  
5 a red flag is a circumstance that would cause a layman to question an  
6 expert's determinations. A "backdated" is an example of a red flag.  
7 *In re Software Toolworks Inc.*, 50 F.3d at 623-24. One doesn't have to  
8 be an expert to realize a "backdated" contract is an harbinger of  
9 trouble. Not so PwC's and E&Y's treatment of the FLIP. One must be  
10 an accountant, or possess considerable knowledge about accounting, in  
11 order to evaluate the propriety of their accounting determinations.  
12 An underwriter is not required to second guess an accountant's  
13 treatment of a tax shelter. Nor is an underwriter required to perform  
14 complex analysis of a company's cash flow in order to evaluate an  
15 accountant's determinations. This is especially true where, as the  
16 plaintiffs concede, "[t]he [relevant] information was buried in the  
17 financials and difficult for even an experienced analyst . . . to  
18 find[.]" (Plaintiffs' Memorandum Opposing Roth's Motion for Summary  
19 Judgment (Ct. Rec. 819) at 13.)  
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21 In sum, Roth was not required to perform complex financial  
22 analysis, nor was it required to challenge PwC's and E&Y's accounting  
23 determinations. Instead, Roth was obligated to look for red flags.  
24 The plaintiffs have failed to identify any circumstance that should  
25 have put a layman on notice that PwC's and E&Y's accounting  
26 determinations were untrue or misleading. As a result, Roth was

1 entitled to rely upon the accounting determinations that are contained  
2 in the relevant registrations statements. Roth is entitled to summary  
3 judgment on this issue.

#### 4 **OVERALL INVESTIGATION**

5 Roth argues its overall investigation of the registration  
6 statements reflected due diligence. In order to qualify for summary  
7 judgment, Roth must demonstrate a rational jury would be compelled to  
8 find Roth "'had, after reasonable investigation, reasonable ground to  
9 believe and did believe . . . that the statements [in the relevant  
10 documents] were true and that there was no omission to state a  
11 material fact required to be stated therein or necessary to make the  
12 statements therein not misleading." *In re Software Toolworks Inc.*, 50  
13 F.3d at 621 (quoting § 11 of the Securities Act of 1933, 15 U.S.C. §  
14 77k(b)(3)). The test for due diligence is reasonableness. *Id.* Roth  
15 must demonstrate it behaved in the same manner "'a prudent man'" would  
16 behave "'in the management of his own property.'" *Id.* (quoting 15  
17 U.S.C. § 77k(c)).

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19 The plaintiffs acknowledge Roth's initial investigation of Met  
20 and Summit was thorough. Nevertheless, the plaintiffs argue Roth did  
21 not do an adequate job of "bringing forward" its investigation as the  
22 years went by. In that regard, they cite several alleged omissions.  
23 For example, Met's and Summit's business model changed. They began  
24 aggressively loaning money for high-risk commercial ventures. Despite  
25 the dramatic change in the companies' business model, Roth allegedly  
26 did not examine loan files in order to ascertain whether Met and

1 Summit had adequate documentation for the loans they were making.  
2 This omission was inexcusable, according to the plaintiffs, because  
3 Roth received a report from PwC indicating Met and Summit did not have  
4 internal controls that enabled them to assess whether their loan to  
5 value ratios were appropriate. In view of the omissions cited by the  
6 plaintiffs (of which the preceding are only examples), Roth is not  
7 entitled to summary judgment regarding its overall investigation.

8 **IT IS HEREBY ORDERED:**

9 Roth Capital Partners' motion for summary judgment (**Ct. Rec. 784**)  
10 is granted in part and denied in part.

11 **IT IS SO ORDERED.** The District Court Executive is hereby  
12 directed to enter this order and furnish copies to counsel.

13 **DATED** this 28th day of January, 2010.

14  
15 s/ Fred Van Sickle  
16 Fred Van Sickle  
17 Senior United States District Judge  
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