IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF ARKANSAS

OPTICARE et al.,

Plaintiffs,

v. **Civil Action**
No. 001-CV-2650-SNL

GRADY JOHNSON, M.D.,
F.A.C.S., Professional Corporation, et al.,

Defendants.

MOTION TO DISMISS

Introduction

This case involves a commercial dispute between parties to the sale of a business, namely, an ophthalmological practice. The seller was a doctor engaged in practice (Complaint ¶¶ 5, 6, 7), and the buyer was a corporation engaged nationally in the management of ophthalmological medical practices throughout the country. (Complaint ¶¶ 1, 2.)[1] The transaction was negotiated and entered into in late 1996 and early 1997.

The gravamen of the complaint is that the defendant represented that his business complied with the requirements of various licenses and programs, including the Medicare

[1]The plaintiffs are a Delaware corporation and its wholly owned subsidiary, a Missouri corporation. The defendants include Dr. Grady Johnson, his professional corporation, and his eye clinic, all resident and based in Missouri. For the sake of clarity and simplicity and since the separate identity of the defendant parties makes no difference to the issues presented herein, the defendants are collectively referred to herein as the defendant.

program, and that, unbeknownst to the plaintiffs, some of Dr. Crandle's medical procedures were not medically indicated, thus rendering their qualification for Medicare coverage in doubt.

One would suppose that this would amount, if anything, to a contractual dispute, but plaintiffs instead characterize the purported failing as fraud. Absolutely no facts are presented to show why this would be fraud. Even more surprising in a case necessarily involving the technicalities of medical judgment, no facts are pleaded to show definitively *that Dr. Johnson actually knew* that his procedures would be judged after the fact to have been medically not indicated, if that is really so. We are not even told by the plaintiffs the basis for their conclusion that the procedures were not medically indicated. Thus, for all that is alleged in the complaint, Dr. Johnson neither knew at the time nor knows now why the plaintiffs have decided that his procedures were not medically indicated.

Despite the utter lack of foundation for the charge, the plaintiffs have elected to file a securities fraud complaint against Dr. Johnson and his business entities. Fraud is a serious allegation and must be carefully pleaded and supported. To fail to do so is an abuse of the litigation process, as the decisions of this Court and those of the United States Courts of Appeals, including the Eighth Circuit, have repeatedly held. The groundless assertion of securities fraud has been deemed to constitute such a serious abuse of the litigation system that Congress has passed a statute expressly dealing with it and has provided strict remedies, including dismissal and attorney's fees, for the wronged defendant. This is a case in which such remedies ought to be applied.

ARGUMENT

I. DEFENDANT IS ENTITLED TO A JUDGMENT DISMISSING THE SECURITIES LAW COUNTS.

The entire factual basis for the securities fraud allegations consists of the fact that Dr. Johnson had

> treated patients and billed the Medicare program for services where neither the patient's diagnosis nor clinical data indicated that the service was medically indicated.

(Complaint ¶ 31.) The procedures which were not medically indicated were evidently laser iridotomies for narrow angle glaucoma for patients for whom the clinical findings did not support a diagnosis of narrow angle glaucoma. (*Id.*) These allegations are the sum total and substance of this supposed securities fraud case.

The law requires much more than that of plaintiffs bringing securities claims. Plaintiffs are required to set forth all of the facts relating to supposed misleading statements or omissions of material facts. In the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737, Congress expressly requires as follows:

> In any private action arising under this chapter in which the plaintiff alleges that the defendant—
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> (A) made an untrue statement of a material fact; or
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> (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;
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> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

15 U.S.C.A. § 78u-4(b)(1) (West 1997). In the case at bar, plaintiffs have pleaded absolutely nothing that is alleged to show that the defendant made any false statements, that is, statements which were untrue at the time they were made. This falls short—completely and absolutely—from what the law requires in showing the securities fraud guilty knowledge required in securities fraud actions.

As already noted, plaintiffs have not bothered to mention why they think the procedures in question had not been medically necessary at the time—a matter far from self-evident—but even if they had given this basis for their claim, no claim of fraud would be presented here. Nothing is said to show why the failure on Dr. Johnson's part would have been fraudulent nor even why he would necessarily have known that his warranties were incorrect. To state a claim of fraudulent scienter, Congress has expressly required a detailed statement of facts strongly supporting the allegation of fraudulent intent:

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity *facts giving rise to a strong inference that the defendant acted with the required state of mind*.

15 U.S.C.A. § 78u-4(b)(2) (emphasis added). Plaintiffs have not even attempted to show false statements by Dr. Johnson, known to have been false at the time they were made, and have utterly failed to allege a specific intent to defraud, as required by the stringent terms of the statute. The plaintiffs having failed to do so, their complaint must be dismissed by the Court.

> In any private action arising under this chapter, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

15 U.S.C.A. § 78u-4(b)(3)(A).

While in certain ways making more strict the pleading requirements in securities fraud cases, the PSLRA's requirements so blatantly ignored by the plaintiffs in deciding to file this action are hardly new. Rather, these basic principles have been long well established among every federal court in the land. Scienter is a necessary element of every Rule 10-b(5) claim. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). The term is defined as "a mental state embracing intent to deceive, manipulate or defraud." *Id.* at 194 n.12.

The serious element of scienter must be specifically pleaded, not presumed, as the plaintiffs have done here. As this Court has held,

> general averments of scienter are insufficient. Rote conclusory allegations that defendants "knowingly did this" or "recklessly did that" fail to meet the heightened pleading requirements of Rule 9(b). . . . Plaintiff "must plead some factual basis giving rise to a *strong inference of fraudulent intent*." *In re Marion Merrell Dow Inc. Securities Litigation II*, No. 93-0251-CV-W-6, 1994 W.L. 396187 *8 (W.D. Mo. July 18, 1994). . . . Allegations are inadequate to indicate conscious behavior on the part of defendant when the "complaint contains no assertion of any fact that makes it reasonable to believe that the defendants knew that any of their statements were materially false or misleading when made." *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1068-69 (5th Cir. 1994).

Jakobe v. Rawlings Sporting Goods Co., 943 F. Supp. 1143, 1153-54 (E.D. Mo. 1996) (emphasis added); *see also In re Baesa Securities Litigation*, 969 F. Supp. 238, 242 (S.D.N.Y. 1997) (under PSLRA and contrary to prior law, pleading of motive and opportunity does not automatically suffice to raise required "strong inference" of fraudulent scienter); *Norwood Venture Corp. v. Converse, Inc.*, 959 F. Supp. 205, 208 (S.D.N.Y. 1997)

(under PSLRA, plaintiff in private securities litigation must now plead specific facts that "create strong inference of knowing misrepresentation on the part of defendants"); *In re Silicon Graphics, Inc. Securities Litigation*, 970 F. Supp. 746, 766 (N.D. Cal. 1997) (to plead scienter, plaintiff must establish strong inference of knowing or intentional misconduct and must do more than speculate as to defendants' motives or make conclusory allegations of scienter, but rather must allege specific facts); *Zeid v. Kimberley*, 973 F. Supp. 910, 918 (N.D. Cal. 1997) (allegations of scienter must be based on a substantial factual basis in order to create a "strong inference" that the defendant acted with the required state of mind).

Merely assuming a certain state of facts on the part of the party making a representation, which is at most all that the complaint suggests, is not enough to show a fraudulent misrepresentation. *See In re Baesa Securities Litigation*, 969 F. Supp. at 243 (parent corporation's accepting at face value its Brazilian subsidiary's financial statements, later discovered to be fraudulent, did not create strong inference of fraud under PSLRA). Moreover, the mere receipt of fees or payment is not sufficient to show a strong inference of fraud. *In re Health Management, Inc. Securities Litigation*, 970 F. Supp. 193, 202 (E.D.N.Y. 1997) (receipt of professional fees is insufficient motive to plead "strong inference" of fraudulent intent as required to establish scienter under PSLRA).

This is especially so here, since what the plaintiffs are really complaining about is that defendant's warranties proved, in the future, to be wrong. Whatever it is which they have learned since then that convinces them otherwise now, it is evident that hindsight is being employed by the plaintiffs to determine after the fact that the medical procedures used by Dr. Johnson were not medically necessary.

> As in the case of scienter, Rule 9(b)'s particularity requirement is heightened even further with respect to forward-looking statements, which are protected by a "safe harbor" provision unless they are made in bad faith or without a reasonable basis. *See* 17 C.F.R. § 240.3b-6 (stating that a forward-looking statement "shall not be deemed to be a fraudulent statement . . . unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith"); *In re Bally Mfg. Sec. Corp. Litig.*, 141 F.R.D. 262, 271 (N.D.Ill.1992) (Aspen, J.) (dismissing a securities fraud claim because of the safe harbor provision), *aff'd*, 2 F.3d 1456 (7th Cir.1993). Hence, when forward-looking statements are alleged to be fraudulent, the "plaintiffs must allege 'specific facts which illustrate that [the defendant's] predictions lacked a reasonable basis.'" *In re HealthCare*, 75 F.3d at 281 (quoting *Arazie v. Mullane*, 2 F.3d 1456, 1468 (7th Cir.1993)); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 513 (7th Cir.1989.)

Fugman v. Aprogenex, Inc., 961 F. Supp. 1190, 1196 (N.D. Ill. 1997); *see also Jakobe v. Rawlings Sporting Goods Co.*, 943 F. Supp. at 1153 (when forward-looking statements are alleged to be fraudulent under § 10(b) and Rule 10b-5, complainant must allege specific facts which illustrate that prediction lacked reasonable basis when made); *In re Glenayre Technologies, Inc. Securities Litigation*, 982 F. Supp. 294, 297 (S.D.N.Y. 1997) (investor's allegation that pager manufacturer failed to disclose pending FCC freeze on new paging license applications failed to plead fraud for particularity, as required by PSLRA, absent allegation that manufacturer had prior knowledge of the freeze).

Not only have the plaintiffs failed to show any fraudulent intent, they have also failed to show loss causation here. The PSLRA provides as to loss causation as defined in and used in securities litigation that

> In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

15 U.S.C.A. § 78u-4(b)(4). Even assuming for argument's sake that plaintiffs have pleaded that they would not have entered into the transactions complained of had they known of the purported misinformation, they have not pleaded anything to show that they were, or how they were, harmed by the supposed misinformation. Nothing is shown to demonstrate that their business is worth less than it would otherwise be and neither has any other loss been shown. Transaction causation and loss causation are distinct elements and both must be shown in order to prevail in a securities claim. *Arthur Young & Co. v. Reves*, 937 F.2d 1310, 1327-28 (8th Cir. 1991), *aff'd*, 507 U.S. 170 (1993) (analyzing transaction and loss causation under Rule 10b-5 and noting that "the two showings are analytically distinct"); *Harris v. Union Electric Co.*, 787 F.2d 355, 366 (8th Cir.), *cert. denied*, 479 U.S. 823 (1986) (transaction causation is nothing more than "but for" causation, but loss causation, on the other hand, is the nexus between the defendant's fraudulent conduct and the plaintiff's pecuniary loss); *In re Glenayre Technologies, Inc. Securities Litigation*, 982 F. Supp. at 297 (no fraud pleaded since plaintiffs failed to allege facts indicating causal link between alleged failure to disclose and any subsequent losses). As the Eighth Circuit has held,

> [i]n order to prevail in an action for securities fraud under § 10(b) and Rule 10b-5, a plaintiff must show some causal nexus between the defendant's wrongful conduct and his (the plaintiff's) loss. This requirement preserves the basic concept that causation must be proved else defendants could be held liable to all the world.

St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 562 F.2d 1040, 1048 (8th Cir. 1977), *cert. denied*, 435 U.S. 925 (1978).

The plaintiffs having failed to plead any facts to support their conclusion that Dr. Johnson committed fraud, and having failed as well to plead loss causation, their federal securities claim is barred absolutely.

For the same reasons, the plaintiffs' very conclusorily pleaded claim under the Missouri Uniform Securities Act must also be dismissed. The Missouri statute may be construed in light of the authority cited—the PSLRA, of course, excepted—since the statute likewise requires that, for one to be liable for selling a security by means of an untrue statement or omission of material fact, he *must himself have not known of the falsehood or omission*. Mo. Ann. Stat. § 409.411(a)(2) (West Supp. 1998); *see also Scheve v. Clark*, 596 F. Supp. 592, 596 (E.D. Mo. 1984) (finding that defendant acted with scienter, giving rise to liability for violation of Missouri Uniform Securities Act).

II. DEFENDANT IS ENTITLED TO A DISMISSAL OF THE COMMON-LAW FRAUD COUNT.[2]

Under Missouri Law, the elements of common-law fraud are

> a representation; its falsity; its materiality; the speaker's knowledge of the falsity or his ignorance of its truth; the speaker's intent that his statement should be acted upon by the person and in the manner reasonably contemplated; the [h]earer's ignorance of the falsity of the statement; his reliance on its truth; his right to rely thereon; and his consequent and proximately caused injury.

Ackmann v. Keeney-Toelle Real Estate Co., 401 S.W.2d 483, 488 (Mo. 1966); *see also Wood v. Robertson*, 245 S.W.2d 80, 82 (Mo. 1952) (same); *Wilburn v. Pepsi Cola*, 410 F.

[2]The fourth count for rescission, although devoid of theoretical explanation, presumably relies on the purported fraud already complained of. It therefore also fails for lack of allegations tending to show fraud for the reasons shown herein.

Supp. 348, 351 (E.D. Mo. 1976) (same, applying Missouri law). It is axiomatic and essential that an accusation of fraud be pleaded with specificity. "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Fed. R. Civ. P. 9(b). As the Eighth Circuit has held,

> [b]ecause one of the main purposes of the rule [FRCP 9(b)] is to facilitate a defendant's ability to respond and to prepare a defense to charges of fraud, . . . *conclusory allegations that a defendant's conduct was fraudulent and deceptive are not sufficient* to satisfy the rule.

Commercial Property Investments, Inc. v. Quality Inns International, Inc., 61 F.3d 639, 644 (8th Cir. 1995) (citations omitted; emphasis added). As this Court has noted, Rule 9(b) of the Federal Rules of Civil Procedure

> serves three very important purposes: 1) It deters the filing of a complaint in order to discover a wrong . . . 2) It protects defendants from the harm that results when they are charged with a crime of moral turpitude. 3) It serves to insure that allegations of fraud are particularized enough in order for the defendant to answer.

Stewart v. Fry, 575 F. Supp. 753, 756 (E.D. Mo. 1983); *see also DiVittorio v. Equidyne Extractive Industries, Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (Rule 9(b) protects defendant from harm to his reputation or goodwill and reduces the number of strike suits); *Kellman v. ICS, Inc.*, 447 F.2d 1305, 1310 (6th Cir. 1971) (dismissal for failure to plead particulars in fraud allegations "is desirable in order to prevent irresponsible and improvident aspersions and charges of fraud") (quoting Barron & Holtzoff, *Federal Practice and Procedure*). The plaintiffs have, as already shown in connection with the securities fraud allegations, completely ignored these rules in asserting their conclusory accusations of fraud. No facts

were pleaded to show that Dr. Johnson knew that his warranties as to compliance were not fulfilled. Indeed, we are not even told why those warranties were not in fact accurate.

The lack of any showing of fraudulent scienter is not the only fatal defect in the fraud count. As with the securities counts, plaintiffs fail to show any loss flowing from the supposed fraud. It is well established that causation in fact is an essential element of an action for common-law fraud under Missouri law. *See Jones & Laughlin Steel Corp. v. Sedalia Industrial Loan & Investment Co.*, 315 F.2d 58, 61-62 (8th Cir. 1963) (element of proximate injury is as important an element of fraud under Missouri law as any other); *Mills v. Keasler*, 395 S.W.2d 111, 118 (Mo. 1965) (plaintiffs could not recover for fraud where they had not shown that they were damaged thereby); *Bales v. Lamberton*, 322 S.W.2d 136, 138 (Mo. 1959) ("Where a party has not sustained any damages as a result of the fraud charged, it is the general rule that no action for damages may be maintained").

Finally, it should be noted that the strict pleading requirements mandated by federal law and ignored by the plaintiffs are not limited to federal securities law claims but rather apply to any averments of fraud made in federal court. *See, e.g.*, *Murr Plumbing, Inc. v. Scherer Brothers Financial Services Co.*, 48 F.3d 1066, 1069 (8th Cir. 1995) (particularity requirements of Rule 9(b) apply to allegations of mail and wire fraud in RICO cases). This includes accusations of fraud arising under state law as well. *In re General Motors Anti-Lock Brake Products Liability Litigation*, 966 F. Supp. 1525, 1536 (E.D. Mo. 1997) (pleading specificity requirements of Rule 9(b) for fraud claims apply as well to state consumer fraud statutes); *NCC Sunday Inserts, Inc. v. World Color Press, Inc.*, 692 F. Supp.

327, 330 (S.D.N.Y. 1988) (requirements of Rule 9(b) apply to state-based deceptive trade practices claims because Rule 9(b) is procedural Rule).

III. THE DEFENDANT IS ENTITLED TO THE ATTORNEY'S FEES IT HAS INCURRED IN DEFENDING AGAINST THIS ACTION.

For the reasons shown, Dr. Johnson has been put to considerable expense thus far in defending against a federal securities claim which manifestly lacks the facts to support it. This is an abuse of litigation and, unfortunately, a well-known one. In response to the prevalence of this abuse, Congress has produced a remedy for the abused defendant. In amending the Securities Exchange Act by the Private Securities Litigation Reform Act of 1995, Congress provided for relief to a defendant who has suffered loss from unsupported accusations of securities fraud. It did so by adopting directly into the Exchange Act—*as a substantive right*—the provisions of Rule 11 of the Federal Rules of Civil Procedure. The Act provides as follows:

> *In any private action* arising under this chapter, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

15 U.S.C.A. § 78u-4(c)(1) (emphasis added). This provision must, of course, be read in light of the strict substantive pleading requirements imposed by the same Act, which require that a plaintiff show, at a minimum, *a strong inference* that the plaintiff is entitled to relief. *Fugman v. Aprogenex, Inc.*, 961 F. Supp. at 1195 (PSLRA requires facts sufficient to create strong inference of fraud); *Norwood Venture Corp. v. Converse, Inc.*, 959 F. Supp. at 208-09 (failure to show loss causation violated PSLRA requirements).

The plaintiffs' violation of these basic requirements mandates the imposition of sanctions in this case. The Act further provides:

> If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) . . . as to any complaint . . . , the court *shall impose sanctions on such party or attorney* in accordance with Rule 11[.]

15 U.S.C.A. § 78u-4(c)(2) (emphasis added). That sanction is, *presumptively*, to award the nonoffending party its attorney's fees and all other expenses incurred as a result.

> [F]or purposes of paragraph (2), the court *shall adopt a presumption* that the appropriate sanction—
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> . . . .
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> (ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) . . . is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

15 U.S.C.A. § 78u-4(c)(3)(A)(ii) (emphasis added).

CONCLUSION

In the final analysis and judging from the absolute paucity of fraud allegations in the complaint, it appears that the plaintiffs may have come to the decision that they were unable to do as well with the new venture they acquired from Dr. Johnson as they had hoped. Or, perhaps, they simply have decided to reallocate their resources in some other fashion. Whatever the reason, being a large company with ophthalmological operations throughout the country (Complaint ¶ 1), plaintiffs clearly have the financial resources to effect a divestment of their new investment by way of securities litigation, as they have evidently chosen to do. But investment disappointments are not a valid ground for accusations of securities fraud, and investor

> misfortune alone does not create a viable cause of action. "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. Securities laws protect investors against fraud; they do not provide investors with a recourse against unsuccessful management strategies." *Searls v. Glasser*, 64 F.3d 1061, 1069 (7th Cir.1995).

Parnes v. Gateway 2000, Inc., 122 F.3d 539, 551 (8th Cir. 1997). The plaintiffs have clearly pleaded the basis for their claims and have just as clearly shown that theirs is—at its most charitably construed best—a contracts claim based on the warranties negotiated at the time of the transaction. A complaint may be dismissed without leave to replead if the claim shows that "the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Fusco v. Xerox Corp.*, 676 F.2d 332, 334 (8th Cir. 1982). Such an order is

warranted here to prevent further abuse of the weaker by the stronger party. The Court is therefore justified in dismissing this meritless complaint without leave to amend.

Respectfully submitted,

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