SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 56
---X
STATE OF NEW YORK and ELIOT SPITZER,
Attorney General of the State of New York, for and
on behalf of the People of the State of New York,
Plaintiffs,

Index No.: 403855/02
DECISION/ORDER

-against-

CLARK E. McLEOD,
Defendant.
---X
HON. RICHARD B. LOWE, J.S.C.:

The motions with sequence numbers 004 and 005 are hereby consolidated for disposition. The former is plaintiffs' motion for partial summary judgment on the complaint, and the later is defendant's motion for summary judgment to dismiss the complaint. For the following reasons, both motions are granted in part and denied in part.

BACKGROUND

Defendant Clark E. McLeod (McLeod) is the former CEO of McLeodUSA Inc. (McLeodUSA), a bankrupt telecommunications company that is incorporated in Delaware and maintains its principal place of business in Iowa. See Notice of Motion (motion sequence number 004), Exhibit 1 (second amended complaint), ¶ 15. McLeod is the last remaining defendant in this civil fraud action that the New York State Attorney General (the "AG") originally commenced against the top executives of four large telecommunications companies[1] "on behalf of the People

[1] The former defendants in this action were Bernard J. Ebbers (Ebbers), the former CEO of WorldCom, Inc. (WorldCom), Stephen A. Garofalo (Garofalo), the former chairman of Metromedia Fiber Networks, Inc. (Metromedia), and Philip F. Anschutz (Anschutz) and Joseph P. Nacchio,respectively the former chairman and the former CEO of Qwest Communications International, Inc (Qwest). Id. ¶ 1.

of the State of New York" (hereinafter "the State") The State alleges that, between approximately 1997 and 2001, McLeod and the other executives received vast, illicit compensation for participating in a "stock spinning" scheme to the detriment of their respective companies and to the investing public.[2] Id., ¶ 1. This scheme was operated by certain investment bankers and financial analysts employed by non-party Salomon Smith Barney (SSB). Id. The central figure was Jack Grubman (Grubman), who was employed as an SSB financial research analyst specializing in the telecommunications industry, but whom the State alleges played an improper dual role as an investment banker. Id., ¶ 47. The complaint specifically alleges that Grubman's goal was to ensure that McLeod and the other telecommunications executives would cause their companies to continue to retain SSB, and to continue to pay SSB's considerable investment banking fees. Id., ¶ 48. In order to do this, Grubman purportedly had certain SSB employees identify privately held companies for which SSB was preparing potentially lucrative "IPO's" (i.e., "initial public offerings" of their stock), and then caused those employees to divert large quantities of those companies' stock into "private wealth management" accounts that SSB maintained for McLeod and the other executives. Id., ¶ 26. Afterwards, in their official roles as SSB financial research analysts, Grubman and other SSB employees heavily touted these companies' stock, both publically and privately, so as to drive up the price of that stock prior to the launching of the companies' IPOs. Id., ¶ 48. As a result, McLeod and the other executives

[2] McLeodUSA, WorldCom and Metromedia all filed for bankruptcy protection in 2002. Id. ¶¶ 68, 74, 90. Qwest did not, but its board demanded that Anschutz and Nacchio resign in that year. Id. ¶ 84. The AG reached quick settlement agreements with former defendants Garofalo, Anschutz and Nacchio in this action. Id. ¶ 1. By an order dated April 12, 2005, the court severed the AG's claims against Ebbers in the wake of Ebbers' conviction for securities fraud in a related federal criminal action.

for whom SSB maintained "private wealth management" accounts were able to sell the inflated stock quickly at a huge personal profit. Id., ¶ 67. However, the State alleges that Grubman and the other analysts knew that stock of the companies that they were touting was not likely to be profitable, and that the price of that stock would decrease dramatically at some point after their IPOs had been consummated. Id., ¶ 49. The State also asserts that McLeod and the other executives were aware of this too, but nonetheless ensured that their respective companies continued to retain and pay SSB so that they, themselves, would continue to reap millions of dollars in personal profit from short-swing sales of the inflated IPO stock. Id., ¶¶ 74-82. Thus, at bottom, the "stock spinning scheme" described in the complaint was merely a somewhat sophisticated form of bribery.

With respect to McLeod in particular, the complaint alleges the following: That McLeod caused McLeodUSA to retain SSB as its investment bank between June of 1996 and January of 2001, and that SSB charged McLeodUSA $77.3 million in fees during that time. Id., ¶ 74. That on 32 occasions between September of 1997 and September of 2000, SSB allocated shares of "hot IPO" stock to a "personal wealth management" account that McLeod opened at SSB, and that McLeod realized $9,430,901.00 in personal profit through sales of that stock. Id., ¶¶ 75-76. That Charles Bobrinskoy (Bobrinskoy),[3] an SSB investment banker, directly intervened to ensure that McLeod received "hot IPO" stock allocations, either from SSB or directly from the offering companies, and that Bobrinskoy also coordinated McLeod's "hot IPO" stock allocations with SSB's "personal wealth management" division. Id., ¶ 78. That Grubman attended a

---

[3] Bobrinskoy was an SSB investment banker who was employed as a member of SSB's "senior relationship management team," and was SSB's main liaison with McLeodUSA. See Plaintiff's Statement of Material Facts, ¶¶ 109-113; Exhibit 27.

McLeodUSA board meeting in 2001 at McLeod's request, and thereafter began touting McLeodUSA's stock. Id., ¶¶ 80-81. That McLeod sold some 2.2 million shares of his personal McLeodUSA stock after Grubman began touting it, and eventually realized a profit of approximately $99 million from those sales.[4] Id., ¶ 82. That McLeodUSA filed for Chapter 11 bankruptcy protection on January 30, 2002. Id., ¶ 74. Finally, that McLeod never disclosed either his relationship with SSB, or any record of his personal profits, or his knowledge that SSB had artificially inflated the price of McLeodUSA's stock, to either McLeodUSA's shareholders or its board of directors. Id., ¶ 67.

In support of the foregoing allegations, the State presents the following evidence: First, McLeod's deposition testimony and interrogatory responses in which he admits having received 34 IPO stock allocations from SSB between 1997 and 2000 that he sold for an aggregate personal profit of $9,962,484.00, as well as documentary proof of those transactions. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 10-11; Exhibits 1, 8, 9 and 10 to Plaintiff's Statement of Material Undisputed Facts. Second, the deposition testimony of SSB employee Richard Olson

---

[4] The court notes that the materials submitted in support of the State's motion and in opposition to McLeod's motion contain no evidence regarding McLeod's alleged sale of his personal McLeodUSA stock. Indeed, the AG's opposition materials indicate that "McLeod's ability to sell his shares of McLeodUSA was restricted by a Stockholders' Agreement, entered into on November 18, 1998." See Plaintiff's Statement of Facts in Opposition to Defendant's Motion for Summary Judgment, ¶ 34. Thus, the AG appears to have abandoned the initial allegation that McLeod realized profits from the sale of his "spun" McLeodUSA stock. However, the opposition material makes the alternate allegation that McLeod sought and received "margin loans" (i.e., lines of credit) from SSB totaling approximately $95 million for which he pledged his "spun" McLeodUSA stock as security. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 137-144. The State supports this allegation with copies of the margin loan agreements between McLeod and SSB. Id., Exhibits 49, 50, 54.

(Olson)[5] that McLeod instructed him to acquire and sell IPO stock on numerous occasions, either personally or by using McLeodUSA employee Steve Knapp (Knapp)[6] as a go-between. Id., ¶¶ 75-76, 87-101; Exhibits 20, 33. Third, Knapp's deposition testimony that either he or McLeod instructed SSB employee Elizabeth O'Connell (O'Connell)[7] to acquire IPO stock for McLeod on numerous occasions. Id., ¶¶ 102-109; Exhibit 33. Fourth, Knapp's and Bobrinskoy's deposition testimony that they intervened to ensure that McLeod received IPO stock allocations, either from SSB or directly from the offering companies, and that afterwards they together coordinated McLeod's IPO stock allocations with SSB's "personal wealth management" division. Id., ¶¶ 109-113; Exhibits 27, 33. Fifth, McLeod's own deposition testimony and interrogatory responses that he personally requested authorization to purchase IPO stock from the CEO's of several companies that McLeodUSA did business with and that SSB was "taking public," as well as corroborating testimony from those CEOs. Id., ¶¶ 114-130; Exhibits 1, 5, 10, 12, 33, 35, 36, 38, 39, and 42. Finally, McLeod's own deposition testimony and interrogatory responses that he did not inform either McLeodUSA's shareholders or McLeodUSA's board of directors that he had ever received or sold any of the IPO stock that SSB had allocated to him, or profited thereby. Id., ¶¶ 16-18; Exhibits 1, 10.

---

[5] Olson and David Trautenberg (Trautenberg) were the two SSB employees who made up SSB's "personal wealth management" division. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 29-30, Exhibits 14, 19, 20.

[6] McLeod hired Knapp as an employee of McLeodUSA, however Knapp's duties were to act as McLeod's personal financial advisor and business manager. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 82-86, Exhibit 33.

[7] O'Connell was a vice president of SSB's "equity capital markets" division. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 79-81.

The second amended complaint asserts causes of action against McLeod for: 1) making a "material misstatement or omission," in violation of General Business Law Article 23-A, by failing to disclose his receipt of "hot IPO" stock allocations to McLeodUSA's shareholders and potential investors; 2) making a "material misstatement or omission," in violation of General Business Law Article 23-A, by failing to disclose his receipt of "hot IPO" stock allocations to McLeodUSA's board of directors ; 3) participating in a "fraudulent illegal scheme," in violation of General Business Law Article 23-A, by receiving "hot IPO" stock allocations from SSB and by profiting from their sale; 4) unjust enrichment; 5) perpetrating "deceptive acts and practices" against McLeodUSA Inc. in violation of General Business Law § 349; and 6) committing "repeated and persistent fraudulent activity" against McLeodUSA in violation of Executive Law § 63 (12). Id., ¶¶ 94-102. The State now moves for partial summary judgment against McLeod on the first, second, third, fourth and sixth causes of action (motion sequence number 004). In response, McLeod moves separately for summary judgment to dismiss the entire complaint against him (motion sequence number 005).

DISCUSSION

When seeking summary judgment, the moving party bears the burden of proving, by competent, admissible evidence, that no material and triable issues of fact exist. See e.g. Winegrad v New York Univ. Med. Ctr., 64 NY2d 851 (1985); Sokolow, Dunaud, Mercadier & Carreras LLP v Lacher, 299 AD2d 64 (1st Dept 2002). Once this showing has been made, the burden shifts to the party opposing the motion to produce evidentiary proof, in admissible form, sufficient to establish the existence of material issues of fact which require a trial of the action. See e.g. Zuckerman v City of New York, 49 NY2d 557 (1980); Pemberton v New York City

Trans. Auth., 304 AD2d 340 (1st Dept 2003). However, "'averments merely stating conclusions, of fact or of law, are insufficient' to 'defeat summary judgment.'" Banco Popular North America v Victory Taxi Management, Inc., 1 NY3d 381, 383 (2004). Because it deprives the litigant of his or her day in court, summary judgment it is considered a drastic remedy which should only be employed when there is no doubt as to the absence of such triable issues. See e.g. Andre v Pomeroy, 35 NY2d 361 (1974); Pirrelli v Long Island R.R., 226 AD2d 166 (1st Dept 1996). However, the court's reluctance to employ summary judgment "only serves to swell the trial calendar and deny litigants the right to prompt adjudication of their claims." See Blechman v I.J. Peiser's and Sons, Inc., 186 AD2d 50, 51 (1st Dept 1992), citing Andre v Pomeroy, 35 NY2d at 364. The court will address the State's and McLeod's respective summary judgment motions in turn.

I. The State's Motion

1. The Martin Act Claims

The State's first three causes of action allege that McLeod violated General Business Law Article 23-A (the "Martin Act"). That statute provides that:

> 1. It shall be illegal and prohibited for any person, partnership, corporation, company, trust or association, or any agent or employee thereof, to use or employ any of the following acts or practices:
> (a) Any fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale; ...
> where engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities, as defined in section three hundred fifty-two of this article, regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted [emphasis added].

General Business Law § 352-c. The concept of "fraud" in a Martin Act claim is much more

broadly defined than it is at the common-law. For example, in People v Lexington Sixty-First Associates (38 NY2d 588 [1976]), the Court of Appeals held that the AG need not prove the elements of "reliance" or "scienter" in a Martin Act claim, and that instead:

> the terms "fraud" and "fraudulent practices" [are] to be given a wide meaning so as to embrace all deceitful practices contrary to the plain rules of common honesty, including all acts, even though not originating in any actual evil design to perpetrate fraud or injury upon others, which do tend to deceive or mislead the purchasing public.

Id. at 595. In State v Rachmani Corp. (71 NY2d 718 [1988]), the Court of Appeals also held that where Martin Act claims are predicated on allegations that a party failed to disclose information, the omitted facts must be "material." In Rachmani, the Court of Appeals adopted the United States Supreme Court's formulation that:

> "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote * * *. It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

Id. at 726, quoting TSC Industries, Inc. v Northway, Inc., 426 US 438, 449 (1976).

Here, the State argues that McLeod committed three "fraudulent" acts, within the Martin Act's broad definition of that term, each of which involved omissions of "material" facts, as defined by the Court of Appeals. See Memorandum of Law in Support of Motion, at 22-24, 25-27. The first Martin Act claim alleges that McLeod failed to disclose his receipt of "hot IPO" stock allocations to McLeodUSA's shareholders and potential investors. See Notice of Motion

(motion sequence number 004), Exhibit 1 (second amended complaint), ¶¶ 94-95. The second alleges that McLeod failed to disclose his receipt of "hot IPO" stock allocations to McLeodUSA's board of directors. Id., ¶¶ 96-97. The third alleges that McLeod improperly received "hot IPO" stock allocations from SSB and then profited from their sale. Id., ¶ 98. With respect to all three causes of action, the supporting brief argues that:

> McLeod's actions in seeking and accepting hot IPOs from SSB and McLeodUSA's business partners while approving McLeodUSA's mandates to SSB "placed McLeod in a position of conflict with [his] duties to the corporation." McLeod, ... was "not free to accept this consideration from a company, [SSB], that was doing significant business with [McLeodUSA] and that arguably intended the consideration as an inducement to maintaining the business relationship in the future."
>
> Thus, ... McLeod was in an undisclosed conflict of interest that "tend[ed] to deceive or mislead the public."

See Memorandum of Law in Support of Motion (motion sequence number 004), at 24. The State supports the three Martin Act claims with evidence in the form of: 1) McLeod's deposition testimony and interrogatory responses in which he admits having received 34 IPO stock allocations from SSB that he sold for an aggregate personal profit of $9,962,484.00 (as well as documentary proof thereof); 2) Olson's deposition testimony that McLeod instructed him to acquire and sell IPO stock on numerous occasions either via personal communication or by using Knapp as a go-between; 3) Knapp's deposition testimony that McLeod instructed him and/or O'Connell to acquire IPO stock on numerous occasions; 4) Knapp's and Bobrinskoy's deposition testimony that they intervened to ensure that McLeod received IPO stock allocations, either from SSB or directly from the offering companies, and that afterwards they together coordinated McLeod's IPO stock allocations with SSB's "personal wealth management" division; 5)

McLeod's own deposition testimony and interrogatory responses that he personally requested authorization to purchase IPO stock from the CEO's of several companies that McLeodUSA did business with and that SSB was "taking public" (as well as the corroborating deposition testimony of those companies' CEOs); and 6) McLeod's own deposition testimony and interrogatory responses that he never informed either McLeodUSA's shareholders or McLeodUSA's board that he had received, sold, or realized a profit from any of the IPO stock that SSB had allocated to him or that he has personally acquired. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 16-18, 75-76, 82-86, 87-101, 102-108, 109-113, 117-130; Exhibits 1, 8, 9,10, 20, 27, and 33 to Plaintiff's Statement of Material Undisputed Facts. McLeod does not contest any of this evidence.

Because McLeod does not dispute either receiving and profiting from "hot IPOs," or that he made no disclosures to McLeodUSA's shareholders or board, there are no factual issues before the court. Therefore, the question is whether McLeod's admitted activity amounts to violations of the Martin Act as a matter of law. The State relies upon In re eBay, Inc. Shareholders Litigation (2004 Del Ch Lexus 4 [Del Ch Feb 11, 2004]), a case wherein the Delaware Court of Chancery considered state securities fraud claims that alleged that officers and directors of eBay had improperly profited from a "stock spinning" scheme, like the one at bar, that was operated by eBay's investment bank, Goldman Sachs. The Court of Chancery found that the officers' and directors' actions amounted to violations of Delaware securities law that included usurpation of corporate opportunities, breaches of fiduciary duty and aiding and abetting a conspiracy. The AG argues that this court should make the same finding with respect to his Martin Act claims against McLeod. See Memorandum of Law in Support of Motion, at 24. This

court could very well apply the Delaware Court of Chancery's reasoning because there is likewise very strong evidence in this action that McLeod has breached his fiduciary duties. However, the court declines to do so because the proponent of a of a Martin Act claim in not required to prove that the accused has breached a fiduciary duty. The court also believes that it would be improvident to base a legal finding that McLeod has violated the Martin Act solely on precepts of Delaware law which - although it is persuasive authority - is not controlling in this jurisdiction.

However, federal case law that interprets the Securities Acts of 1933 and 1934 is to be deferred to by New York courts that review Martin Act claims. See e.g. All Seasons Resorts, Inc. v Abrams, 68 NY2d 81, 87 (1986) ("In our application of the statute, we find it appropriate to consider as persuasive authority the decisions of the United States Supreme Court and other Federal courts construing the Federal Blue Sky Laws"); People v First Meridian Planning Corp., 201 AD2d 145 (3d Dept 1994), affd' 86 NY2d 608 (1995). The courts' research has uncovered a decision entitled Monetta Financial Services, Inc. v S.E.C. (390 F3d 952 [7th Cir 2004]) wherein the United States Court of Appeals for the Seventh Circuit upheld the finding that an investment adviser that failed to disclose to its individual clients or to its fund trustees that it had allocated hot IPO stocks to certain directors of its larger mutual fund clients had omitted a "material" fact and, in so doing, had committed "fraud or deceit" within meaning of the federal securities laws. Id. at 955. Although that case dealt only with the investment adviser's liability, the Circuit Court noted that the SEC has also promulgated a rule that requires mutual fund directors to disclose their receipt of such IPO allocations when those allocations are accompanied by "special treatment." Id. at 956; 66 Fed Reg 3734, 3744 (Jan 16, 2001). The Circuit Court indicated that, in either instance, failure to disclose would be a violation of the federal securities laws. Id. It

follows that, because the Martin Act requires less stringent proof that the federal securities laws on which it is modeled, the non-disclosures at issue in Monetta Financial Services would also perforce constitute Martin Act violations.[8] Indeed, the court can discern no rationale under which a corporate director/officer's non-disclosure of his receipt of "hot IPO" stock from his company's investment bank should be deemed any less "material" to the shareholders or board of that director/officer's corporation than an identical non-disclosure by an investment adviser or mutual fund director to his or her clients or fund managers. In either case, there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available,"[9] because it is per se reasonable for any investor who knows that a director/officer has entered into a remunerative relationship with one of the corporation's banks or clients to infer that that director/officer has abandoned or at least compromised his position of trust.[10] Thus, the court

---

[8] The court must also give some weight to the fact that on March 15, 2005, former defendant Ebbers was found guilty in the U. S. District Court for the Southern District of New York of charges including several counts of violating federal securities laws. Ebbers was alleged to have participated in the same "stock spinning" scheme as McLeod. Because that activity resulted in Ebbers' conviction of federal securities fraud, and because the Martin Act requires less stringent proof than the federal securities laws do, it is clear that Ebbers could also be found liable for violating the Martin Act.

[9] State v Rachmani Corp., 71 NY2d at 726.

[10] For example, in Kas v Financial General Bankshares, Inc. (796 F2d 508 [DC Cir 1986] the United States Circuit Court for the District of Columbia Circuit reasoned that "[t]he violation arising from the failure to disclose such a potential conflict of interest does not turn on the failure to disclose a director's true motivations but rather stems from the failure to disclose a fact that puts the shareholder on notice of a potential impairment of the director's judgment. Whether or not the director's underlying action could give rise to liability for a breach of fiduciary duty under state law is not relevant. The information by itself is material for the shareholder to place the director's recommendation in perspective. Armed with such knowledge, a reasonable shareholder will scrutinize a director's recommendation more critically." Id. at 513 (internal

finds that McLeod's non-disclosures are "material" for Martin Act purposes. The court also finds that McLeod's non-disclosures are "fraudulent," within the statute's broad definition, because they clearly "tend[ed] to deceive or mislead the purchasing public"[11] as to the totality of the reasons underlying McLeod's decisions to have McLeodUSA retain SSB and/or to act on any of SSB's investment advice.[12] Coupled with McLeod's admitted non-disclosure, the existence of such "materiality" and "fraud" is sufficient to prove the Martin Act claims against McLeod. Accordingly, the court finds that the State is entitled to summary judgment on those causes of action. Nonetheless, McLeod raises five arguments in opposition to the State's motion.

A. The AG IS Actually Pursuing Claims on Behalf of McLeodUSA

McLeod first asserts that, as a matter of law, the AG "may not pursue breach of fiduciary duty claims on behalf of McLeodUSA" for three reasons. See Memorandum of Law in Opposition to Motion, at 8-17. The first reason is that the April 5, 2002 order of the United States Bankruptcy Court for the District of Delaware that confirmed McLeodUSA's Chapter 11 bankruptcy reorganization plan included both a release of any claims by McLeodUSA against McLeod, and a permanent injunction against "any entity" from pursuing such released claims. Id., at 8-10; Notice of Motion (motion sequence number 005), Geremia Affidavit, Exhibit Z (bankruptcy court order). The State responds the Martin Act does not bar the AG from pursuing

---

citations omitted); see also People v Tellier, 7 Misc 2d 43 (Sup Ct NY County 1956).

[11] People v Lexington Sixty-First Associates, 38 NY2d 588, 595 (1976), quoting People v Federated Radio Corp., 244 NY 33, 38-39 (1926).

[12] In view of the uncontested facts that he was McLeodUSA's majority shareholder, board chairman and CEO, the court gives no shrift to McLeod's assertion that he "did not control the decision to select [SSB] as an investment banker for McLeodUSA." See Memorandum of Law in Opposition to Motion, at 16.

claims that might also otherwise accrue to a corporation's shareholders. See Plaintiff's Reply Memorandum of Law, at 3-4. That position correctly states the law. Under the Martin Act, "the Attorney General is responsible both for protecting the investing public as a whole," as well as "for redressing harm suffered by individual investors because of misleading or fraudulent practices in connection with the promotion or sale of securities." State v 7040 Colonial Road Associates Co., 176 Misc 2d 367, 369 (Sup Ct NY County 1998), citing People v Landes, 192 AD2d 1 (3d Dept 1993), aff'd 84 NY2d 655 (1994). Thus, the fact that McLeodUSA's shareholders may have[13] discharged their claims against McLeod would not diminish the State's legal authority to enforce the Martin Act on behalf of the investing public.[14]

The second reason McLeod asserts for barring the Martin Act claims against him is that the AG has no parens patriae authority to bring any claims on behalf of a corporation such as McLeodUSA. See Memorandum of Law in Opposition to Motion, at, at 11-12. This argument is based on an erroneous assumption. The Appellate Division, Third Department, has observed that "[a] State has inherent power to sue as parens patriae on behalf of its citizens to prevent harm to its sovereign interests, such as the health, comfort and welfare of its people." Finger Lakes Health Systems Agency v St. Joseph's Hospital, 81 AD2d 403, 407 (3d Dept 1981). In State by

---

[13] The State does not concede that McLeodUSA's shareholders have actually discharged their claims against McLeod. See Plaintiff's Reply Memorandum of Law at 5. However, because of the court's ruling that the State may properly seek relief pursuant to the Martin Act, there is no reason for this court to embroil itself in reviewing either the provisions of the federal Bankruptcy Code or those of the April 5, 2002 order of the United States Bankruptcy Court for the District of Delaware.

[14] For this reason, the two federal Circuit Court decisions involving shareholders' derivative suits that McLeod cites in his brief, In re Ionosphere Clubs, Inc. (17 F3d 600 [2d Cir 1994]) and In re All American of Ashburn, Inc. (805 F2d 1515 [11th Cir 1986]), are factually distinguishable. See Memorandum of Law in Opposition to Motion, at 10.

Abrams v New York City Conciliation and Appeals Bd. (123 Misc 2d 47 [Sup Ct NY County 1984]), this court (Wolin, J.) further explained the concept of "parens patriae authority" as follows:

> The concept of parens patriae is a judicial recognition of the inherent power of the state to prevent injury to those who, for whatever reason, cannot protect themselves. In exercising its prerogative the state is not limited to representation of citizens suffering a particular disability but may bring suit to protect the welfare of any substantial segment of its population. However when the state does bring suit, it must be for redress of wrongs done to the interests of the people as a whole and not merely to vindicate the individual or private interests of certain citizens. If the aggrieved individual has an adequate remedy at law, then the state is merely a nominal party with no real interest of its own. As a nominal party the state would not have the capacity to sue as parens patriae.
>
> In analyzing the standing of a state to maintain an action, the Courts have spoken of the 'quasi-sovereign interests' of the state. While not admitting of a precise definition, a 'quasi-sovereign interest' has been held to consist of a set of interests which the state has in the well-being of its populace. Well-being in this context is broad enough to encompass conditions affecting both the physical and the economic life of the citizens of the state. The interest involved must also be sufficiently concrete to create an actual controversy. The injury complained of cannot be to any purely sovereign or proprietary interest of the state, nor can the state assert the purely private claims of individual citizens. Finally there must be an injury to a sufficiently substantial portion of its population, something more than an injury to an identifiable group of individuals [internal citations omitted].

123 Misc 2d at 49. However, Justice Wolin concluded that the State may not assert its parens patriae authority where there exists a specific grant of statutory authority because "[t]he interest of the state in the proper enforcement and administration of its laws is purely a sovereign one and cannot be the predicate for standing to protect a quasi-sovereign interest." 123 Misc 2d at 50, citing Alfred L. Snapp & Son, Inc. v Puerto Rico, ex rel., Barez, 458 US 592, 599 (1982). Here, the court finds that the State's parens patriae authority is not implicated because the Martin Act and Executive Law § 63 (12) both afford the State independent bases for asserting its claims

against Mcleod. See Plaintiff's Memorandum of Law in Opposition to Motion (motion sequence number 005), at 25; see also Gen. Bus. Law § 353; Exec. Law § 63 (12). Accordingly, the court rejects McLeod's parens patriae argument.

The third reason McLeod advances for barring the Martin Act claims against him is that the law does not permit the State to "bootstrap" claims for breach of fiduciary duty (that belong solely to the shareholders of McLeodUSA) "into a claim for securities fraud." See Memorandum of Law in Opposition to Motion (motion sequence number 004), at 12-17. To support this contention, McLeod cites several federal court decisions that were rendered in the wake of the United State's Supreme Court's holding in Santa Fe Industries, Inc. v Green, 430 US 462 (1977). In Santa Fe, a minority of a corporations' shareholders objected to the allegedly low price that they had received for their stock in a "short form" merger imposed by the majority, and subsequently brought suit against the majority for federal securities fraud on a theory of breach of fiduciary duty. The high court upheld the trial court's dismissal of the minority's cause of action for violation of Section10(b) of the Securities Exchange Act of 1934, and held that "the existence of a particular state-law remedy is not dispositive of the question whether Congress meant of provide a similar federal remedy." Id. at 478.[15] Thus, Santa Fe actually stands for the proposition that McLeod is attempting to refute - i.e., that while securities fraud claims that are based solely on a theory of breach of fiduciary duty may or may not constitute violations of federal law, such claims are properly governed in first instance by individual state laws such as the Martin Act.

---

[15] The federal court decisions that McLeod cites for his "no bootstrapping" proposition are Kas v Financial General Bankshares, Inc. (796 F2d at 508 supra.), First General Resources Co., By and Through Its Trustees v Hartman & Craven (1989 WL 135383 [SD NY 1989]) and Browning Debenture Holders' Committee v DASA Corp., 560 F2d 1078 (2d Cir 1977).

Therefore, McLeod's cases are all clearly inapposite and his argument is unfounded. Further, the State correctly notes that New York State courts have acknowledged the AG's authority to bring concurrent Martin Act claims where a defendant has breached a fiduciary duty.[16] See Plaintiff's Reply Memorandum of Law at 6. Accordingly, the court rejects McLeod's first opposition argument in full.

B. Lack of Materiality

McLeod next argues that all of his purchases of "hot IPO" stock through SSB were "immaterial as a matter of law" because the State has failed to prove that there was any conflict of interest between McLeod and McLeodUSA. See Memorandum of Law in Opposition to Motion, at 18. As was previously stated, the Court of Appeals holds that an omitted fact is "material" if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." State v Rachmani Corp. 71 NY2d at 726, quoting TSC Industries, Inc. v Northway, Inc., 426 US at 449. McLeod presents his materiality argument in three prongs. First, he argues that his omissions were immaterial because McLeodUSA's shareholders did not vote on either the decision to use SSB as McLeodUSA's investment bank, or on "any issue" connected with the client companies from whose CEOs McLeod solicited IPO stock allocations. See Memorandum of Law in Opposition to Motion, at 17-18. The State responds that "numerous cases have held the non-disclosure of a conflict of interest to be material despite the absence of proxy statements or an impending shareholder vote." See Plaintiff's Reply Memorandum, at 9. Although there

---

[16] See e.g. Scalp & Blade, Inc. v Advest, Inc., 281 AD2d 882 (4th Dept 2001); State v Justin, 3 Misc 3d 973 (Sup Ct Erie County 2003); People v Royal Securities Corp., 5 Misc 2d 907 (Sup Ct NY County 1955); People v Florentino, 116 Misc 2d 692 (NYC Crim Ct 1982).

does not appear to be any New York State case law on point, the United States Court of Appeals for the Second Circuit has historically upheld findings that an undisclosed conflict of interest is "material," even in the absence of a shareholder vote. See e.g. Frankel v Slotkin, 984 F2d 1328 (2d Cir 1993); Goldberg v Meridor, 567 F2d 209 (2d Cir 1977). The Circuit Court considers it significant that, in addition to permitting shareholders' derivative suits for securities fraud, New York State's Business Corporation Law also permits aggrieved minority shareholders to seek injunctive (i.e., equitable) relief to stop a controlling shareholder from acting improperly on a conflict of interest. Goldberg v Meridor, 567 F2d at 219-220, citing Securities and Exchange Commission v Parklane Hosiery Co., Inc., 558 F2d 1083 (2d Cir 1977). In the Circuit Court's view, the fact that minority shareholders can pursue the additional equitable remedy negates the argument that non-disclosure of the controlling shareholders' conflict of interest is immaterial because it would have been impossible for the minority shareholders to have voted down the controlling shareholders' actions. Id. Instead, the Circuit Court holds that such non-disclosure is material to the minority shareholders' independent causes of action, which obviously do not depend upon shareholder vote. Id. This court accepts the Circuit Court's analysis with respect to materiality, and holds that it applies with equal force to actions commenced by the AG. As was previously discussed, knowledge of McLeod's relationship with SSB and would certainly have prompted a reasonable investor to question the motives behind McLeodUSA's continued retention of SSB, or of those client relationships that McLeod established on behalf of McLeodUSA with the companies whose CEO's offered him IPO stock, and might well have prompted that investor to seek injunctive relief. The fact that this knowledge was not made available constitutes a "material" omission because it significantly altered the "total mix of

information" available to that investor, as well as substantially diminishing the likelihood that he/she would seek such injunctive relief. As the court has previously noted, the Martin Act authorizes the AG to act on behalf of such an investor. Accordingly, the court rejects McLeod's argument that the fact that McLeodUSA's shareholders did not vote on his actions renders his non-disclosures "immaterial" within the Court of Appeals' definition.

The next prong of McLeod's "materiality argument" is that he did not engage in "the sort of self dealing that [gives] rise to a potential conflict of interest" because: 1) he purchased all of the "hot IPO" shares with his own money, not McLeodUSA's, and therefore did not usurp any corporate opportunities; 2) there was no quid pro quo arrangement between himself and SSB; and 3) there was no quid pro quo arrangement between himself and any of the CEOs of the companies that McLeodUSA did business with that gave him "hot IPOS." See Memorandum of Law in Opposition to Motion, at 19. The State responds that this argument essentially states "that self dealing and conflicts must be disclosed only if they would establish a strict common law claim for usurpation of corporate opportunity," and then notes that "usurpation of corporate opportunity is not a required predicate act to establish a Martin Act violation." See Plaintiff's Reply Memorandum, at 11. The latter observation may well be correct, however it does not squarely address McLeod's argument. The court finds that that argument, once again, misconceives the reach of the Martin Act, which does not require the State to prove that a defendant has engaged in self dealing. As the court noted at the beginning of this decision, the Martin Act touches "all deceitful practices contrary to the plain rules of common honesty, including all acts, even though not originating in any actual evil design to perpetrate fraud or injury upon others, which do tend to deceive or mislead the purchasing public." People v Lexington Sixty-First Associates, 38

NY2d at 595. The court has also previously found that McLeod's non-disclosures were material, and now finds that they did "tend to deceive or mislead the purchasing public" for the same reasons. Thus, all of the factors with which McLeod seeks to support his opposition argument are irrelevant to the instant Martin Act claims. Accordingly, the court rejects the second prong of McLeod's "materiality" argument.

The final prong of McLeod's "materiality" argument is that "there is no evidence that any reasonable shareholder would have deemed disclosure of McLeod's IPO share purchases to have been material in any other way." See Memorandum of Law in Opposition to Motion, at 20. The court has previously addressed this argument and has come to the opposite conclusion. Accordingly, the court also rejects the third prong of McLeod's "materiality" argument for the reasons stated earlier in this decision, and further finds that that argument is meritless as a whole.

C. No Duty to Disclose

McLeod's third opposition argument is that he did not have any duty to disclose his purchases of "hot IPO" stock through SSB. See Memorandum of Law in Opposition to Motion, at 21-23. McLeod initially supports this argument with the 58 year-old holding by the Appellate Division, Second Department, that "concealment of ... material facts ... is not fraudulent unless there is a duty to speak." Dash v Jennings, 272 AD 1073 (2d Dept 1947). However, the State's brief correctly notes that that holding is inapposite because the appellate court was reviewing a common law fraud claim therein, and not a Martin Act claim. See Plaintiff's Reply Memorandum, at 14. McLeod also argues that no federal securities statute or regulation imposes any specific duty of disclosure on him. See Memorandum of Law in Opposition to Motion, at 22-23. However, that argument is also inapposite because Martin Act claims do not derive from federal

securities statutes or regulations. Instead, the court finds that McLeod's fiduciary obligations as the controlling shareholder, board president and CEO of McLeodUSA did, indeed, include the duty to disclose his "hot IPO" stock allocations and trades. BCL § 717; see e.g. Blank v Blank, 256 AD2d 688 (3d Dept 1998) (Officers and directors are fiduciaries of their corporation, owe it their undivided and unqualified loyalty, and may not profit personally at its expense); Quasha v American Natural Beverage Corp., 171 AD2d 537 (1st Dept 1991) (Officers and directors of a corporation owe a fiduciary duty to its shareholders). The Court of Appeals has observed that:

> Because the power to manage the affairs of a corporation is vested in the directors and majority shareholders, they are cast in the fiduciary role of "guardians of the corporate welfare." In this position of trust, they have an obligation to all shareholders to adhere to fiduciary standards of conduct and to exercise their responsibilities in good faith when undertaking any corporate action ... Actions that may accord with statutory requirements are still subject to the limitation that such conduct may not be for the aggrandizement or undue advantage of the fiduciary to the exclusion or detriment of the stockholders.
>
> The fiduciary must treat all shareholders, majority and minority, fairly. Moreover, all corporate responsibilities must be discharged in good faith and with "conscientious fairness, morality and honesty in purpose." Also imposed are the obligations of candor ... and of good and prudent management of the corporation. When a breach of fiduciary duty occurs, that action will be considered unlawful and the aggrieved shareholder may be entitled to equitable relief [internal citations omitted].

Alpert v 28 Williams Street Corp., 63 NY2d 557, 568 (1984), rearg denied 64 NY2d 1041 (1985). The fact that McLeod "profited personally" profited from his "hot IPO" stock trading carried with it the obligation to ensure those to whom he owed fiduciary duties, by full disclosure, that his profit did not come "at their expense." McLeod's admitted failure to disclose may well have constituted a breach of his fiduciary obligations, however, as the court has stated several times, the Martin Act's broad definition of fraud does not require the State to establish all of the

elements of a breach of fiduciary duty claim. Accordingly, the court rejects McLeod's third opposition argument as meritless.

D. No Promotion of Stock Sales

McLeod next argues that the State has failed to prove that his purchases of "hot IPO" stock "induced or promoted" the "purchase or sale" of McLeodUSA securities in violation of the Martin Act. See Memorandum of Law in Opposition to Motion, at 23-25. The State responds that McLeod's argument "seeks to import a scienter requirement into a civil Martin Act claim," but notes that the statute contains no such requirement. See Plaintiff's Reply Memorandum, at 15. Although that statement is accurate, it does not address McLeod's two-part argument. The first part thereof, which alleges that McLeod's activity did not amount to either "inducement" or "promoting" tracks language set forth in GBL §§ 352 (1) and 352-c (1) (a). However, that argument also ignores language set forth in GBL §§ 352 (1) and 352-c (2) which also makes it a violation of the Martin Act to "to engage in any artifice, agreement, device or scheme to obtain money, profit or property by" fraudulent means. Thus, McLeod is incorrect to suggest that he is outside the statute's ambit because was not engaged in "inducing" or "promoting" sales of McLeodUSA stock. Instead, the court finds that his participation in SSB's illicit "stock spinning" scheme is sufficient to subject him to the Martin Act's reach. The court is guided in its decision by earlier decisions in this Judicial District in which courts have upheld Martin Act convictions against defendants who traded on "insider information." See e.g. People v Napolitano, 282 AD2d 49 (1st Dept 2001); People v Florentino, 116 Misc 2d 692 (Crim Ct NY County 1982) (same). Such activity is analogous to "stock spinning" in that an "inside trader" takes information that he/she should reasonably know to be confidential and uses that information to realize "short

swing" stock profits, whereas a "stock spinner" merely takes the stock itself and sells it to realize the same profits. Although purchasing IPO stock is legal, the impropriety lies in the fact that a "stock spinner" also receives the benefit of the investment bank's improper efforts to tout the stock to the investing public and thereby ensure that it will appreciate in value in the short term. Thus, "stock spinning" clearly an "artifice, agreement, device or scheme to obtain money, profit or property by" fraudulent means. Thus, the court rejects the "inducement or promotion" portion of McLeod's argument.

The second part of McLeod's argument asserts that he did not violate the Martin Act because the "purchasing public" did not engage in the "purchase or sale" of McLeodUSA stock. See Memorandum of Law in Opposition to Motion, at 23-25. The State responds that, pursuant to GBL § 352-c (1), a Martin Act violation may occur "regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted." See Plaintiff's Reply Memorandum, at 15. McLeod's argument ignores this language, as well as the fact that there is no requirement of privity of sale under the Martin Act. See e.g. People v Florentino, 116 Misc 2d 692; . Accordingly, the court rejects McLeod's fourth opposition argument in full.

E. Preemption

Finally, McLeod argues that the Martin Act claims against him are preempted by federal law, specifically 15 USA § 77r (a) (2) (B) of the National Securities Market Improvement Act of 1996. See Memorandum of Law in Opposition to Motion, at 26-28. That statute does indeed bar states from making any rules that impose special conditions on any disclosure statements that are required to be filed with the Securities and Exchange Commission (SEC) or the National Association of Securities Dealers (NASD). However, 15 USA § 77r (c) (1) provides that:

> Consistent with this section, the securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.

McLeod has failed to identify any federal law, rule or regulation that governs what he was or was not obligated to disclose to the shareholders or board of McLeodUSA in his fiduciary capacity as the corporation's majority shareholder, board president and CEO. The court was unable to discover any such statute either, however this is understandable in light of the United States Supreme Court's concern that:

> Federal courts applying a 'federal fiduciary principle' under Rule 10b-5 could be expected to depart from state fiduciary standards at least to the extent necessary to ensure uniformity within the federal system. Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden.

Santa Fe Industries, Inc. v Green, 430 US at 479. Accordingly, the court rejects McLeod's preemption argument, and finds that the State is entitled to summary judgment on the first, second and third Martin Act claims herein.

2. Unjust Enrichment

The State's fourth cause of action against McLeod is an equitable claim for unjust enrichment. See Notice of Motion (motion sequence number 004), Exhibit 1 (second amended complaint), ¶ 99. The Appellate Division, First Department, holds that "a 'cause of action for unjust enrichment is stated where "plaintiffs have properly asserted that a benefit was bestowed ... by plaintiffs and that defendants will obtain such benefit without adequately compensating plaintiffs," and that "[m]oreover, '[w]here defendants have reaped such benefit, equity and good

conscience require that they make restitution'." Korff v Corbett, 18 AD3d 248, 251 (1st Dept 2005), quoting Wiener v Lazard Freres & Co., 241 AD2d 114, 119 (1st Dept 1998). However, the Appellate Division has also made it clear that "[w]ith respect to the benefit bestowed on defendants, the receipt of a benefit alone, pursuant to the standard set forth above, is insufficient to establish a cause of action for unjust enrichment." Wiener v Lazard Freres & Co., 241 AD2d 114, 120 (1st Dept 1998). Here, the complaint merely states that:

> By failing to disclose fully and accurately the receipt of IPO allocations from SSB and the details concerning his company's investment banking relationship with SSB, [McLeod] unjustly enriched himself and deprived the investing public of a fair marketplace.

See Notice of Motion (motion sequence number 004), Exhibit 1 (second amended complaint), ¶ 99. In support of the foregoing, the State argues that:

> McLeod was in a clear conflict of interest when he pursued and accepted hot IPOs from SSB while he approved McLeodUSA's mandates to SSB (and when he pursued hot IPOs from McLeodUSA's business partners while McLEodUSA did or might do business with them) and McLeod wrongfully failed to disclose same. By accepting these hot IPO shares, McLeod deprived others more worthy of receiving the benefit including: (1) McLeodUSA and its shareholders; and (2) those investors who sought shares in these IPOs but received fewer (or no) shares because of McLeod's receipt of these shares.

See Memorandum of Law in Support of Motion, at 29. McLeod responds: 1) that the AG may not assert an unjust enrichment claim on behalf of McLeodUSA's shareholders; 2) that McLeod's non-disclosure of his IPO purchases did not deprive McLeodUSA or its shareholders of any property or money, or deprive any member of the public of a "possessory interest" in that stock; and 3) that there was no "direct dealing" or "actual, substantive relationship" between the plaintiff(s) herein and McLeod. See Memorandum of Law in Opposition to Motion, at 28-30. The court rejects McLeod's first argument because the complaint clearly states that the State is

asserting this unjust enrichment claim on behalf of the public. The portion of the above argument that refers to McLeodUSA's shareholders is merely meant to illustrate the wrongful nature of McLeod's actions, and not as a proposal that the State should be permitted to obtain relief on behalf of those shareholders. The court also rejects McLeod's third argument, which alleges absence of direct dealing, because:

> . . . A quasi or constructive contract rests upon the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth, it is not a contract or promise at all. It is an obligation which the law creates, in the absence of any agreement, when and because the acts of the parties or others have placed in the possession of one person money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which Ex aequo et bono belongs to another. Duty, and not a promise or agreement or intention of the person sought to be charged, defines it. It is fictitiously deemed contractual, in order to fit the cause of action to the contractual remedy (citations omitted).

Saunders v Kline, 55 AD2d 887, 888 (1st Dept 1977), mod. on other grounds 53 NY2d 658 (1981), quoting Miller v Schloss, 218 NY 400, 407 (1916). There is no requirement that there be "direct dealing" or a contractual relationship between the parties. However, the court finds that McLeod's second argument is persuasive, even if it uses incorrect terminology.[17] Although the complaint states that McLeod enriched himself, it describes the "benefit" by which he realized that enrichment as "the investing public's deprivation of a fair marketplace." The court finds that such a "benefit" is too inchoate and unquantifiable to serve as a basis for an unjust enrichment claim, pursuant to the holding of Wiener v Lazard Freres & Co. (241 AD2d at 120). The AG's argument that "those investors who sought shares in these IPOs ... received fewer (or no) shares

---

[17] As the holding in Saunders v Kline (55 AD2d at 888) makes clear, the exchange of "property or money" is not required in an unjust enrichment claim because a "benefit" may consist of "money, or its equivalent."

because of McLeod's receipt" thereof does not clarify the matter. Therefore, the court finds that the AG has failed to prove a necessary component of his unjust enrichment claim. Accordingly, the denies the State's motion for summary judgment with respect to the cause of action for unjust enrichment.

3. Executive Law § 63 (12)

The State's final cause of action alleges that McLeod violated Executive Law § 63 (12) by committing "repeated and persistent fraudulent activity" against McLeodUSA. See Notice of Motion (motion sequence number 004), Exhibit 1 (second amended complaint), ¶¶ 101-102. The statute specifically provides that:

> Whenever any person shall engage in repeated fraudulent or illegal acts or otherwise demonstrate persistent fraud or illegality in the carrying on, conducting or transaction of business, the attorney general may apply ... for an order enjoining the continuance of such business activity or of any fraudulent or illegal acts [and] directing restitution and damages.

In People ex rel. Vacco v World Interactive Gaming Corp. (185 Misc 2d 852, 856-857 [Sup Ct NY County 1999]) this court (Ramos J.) observed that:

> Executive Law § 63(12) authorizes the Attorney General to bring a special proceeding against a person or business committing repeated or persistent fraudulent or illegal acts. Any conduct which violates state or federal law or regulation is actionable under this provision. (See State of New York v Ford Motor Co., 74 NY2d 495 [1989]). Under Executive Law § 63(12), fraud has been interpreted broadly requiring only a showing that the action has a potential to deceive. (See People v Apple Health & Sports Clubs, 206 AD2d 266, 267 [1st Dept 1994]). In order for fraudulent or illegal acts to be actionable under Executive Law § 63(12), respondents' activities must be repeated. (See State v Princess Prestige Co., Inc., 42 NY2d 104, 107-108 [1977] [finding that Executive Law § 63(12) does not require a large number of repeated illegal or fraudulent acts]) [emphasis supplied and original citations changed in accordance with court rules].

In this action, the State argues for summary judgment on the Executive Law claim because

"the elements of a claim under § 63 (12) are virtually identical to those under the Martin Act, except for the requirement that the offending behavior be repeated or persistent or affect more than one person." See Memorandum of Law in Support of Motion (motion sequence number 004), at 28. The State concludes that, because McLeod's solicited and traded in "hot IPO" stock "over a period of years, his repeated actions, his continued retention of SSB and his ongoing non-disclosure to McLeodUSA's shareholders and board "clearly affected more than one person," and constituted "exactly the kind of repeated and persistent behavior that the Executive Law was designed to prohibit." Id. The court finds that Executive Law § 63 (12) and the Martin Act both define "fraudulent activity" broadly enough to encompass illicit activity involving securities. See e.g. People v Lexington Sixty-First Associates, 38 NY2d 588; People ex rel. Vacco v World Interactive Gaming Corp., 185 Misc 2d 852. Indeed, McLeod raises no specific legal arguments against the AG's Executive Law § 63 (12) claim, having chosen to treat it as equivalent to the three Martin Act claims in the complaint. However, the court has already rejected all of McLeod's opposition arguments as meritless with respect to those Martin Act claims, and found both that his actions were "fraudulent" and his omissions were "material." In light of the fact that McLeod has admitted that he sought and received "hot IPO" stock allocations on multiple occasions and did not make any disclosures on any of those occasions, the court finds that he has engaged in "repeated" and/or "persistent" fraudulent acts in violation of the statute and, therefore, rejects all of McLeod's opposition arguments with respect to the AG's Executive Law § 63 (12) claim as well. Accordingly, the court finds that the State is entitled to summary judgment on the sixth cause of action herein.

II. McLeod's Motion

McLeod raises four arguments in support of his motion for summary judgment to dismiss the second amended complaint.

1. Lack of Jurisdiction

The first portion of McLeod's motion asserts that the court lacks personal jurisdiction over him. See Memorandum of Law in Support of Motion (motion sequence number 005), at 4-8. To determine whether personal jurisdiction exists over a non-domiciliary such as McLeod, New York State law mandates a two-part jurisdictional analysis in which the court must first determine whether the requirements of the long-arm statute (i.e., CPLR 302) are satisfied and, if so, whether the exercise of jurisdiction would comport with principles of constitutional due process. See e.g. LaMarca v Pak-Mor Mfg. Co., 95 NY2d 210 (2000). Here, the complaint asserts personal jurisdiction because:

> (a) [McLeod] received IPO shares from SSB which has its principal place of business in New York County, New York; (b) the IPO shares were allocated to [McLeod] by and from SSB's syndicate department located at SSB's New York headquarters; and (c) [McLeod] was an officer of a company whose stock was listed and traded on securities markets located within the State of New York.

See Notice of Motion (motion sequence number 005), Complaint, ¶ 12. McLeod argues that the first two of the above jurisdictional bases related to SSB's contacts with New York rather than to his own, and that the third is insufficient as a matter of law. See Memorandum of Law in Support of Motion (motion sequence number 005), at 5. The court notes that these arguments do not address New York's long-arm statute. However, McLeod next argues that that statute does not confer jurisdiction over him either. Id. at 6-8. Oddly, McLeod does not raise any argument about constitutional due process or "minimum contacts" in either of his memoranda of law.

The State argues that McLeod is subject to jurisdiction in New York pursuant to CPLR

302 (a) (1), which provides that "a court may exercise personal jurisdiction over any non-domiciliary, or his executor or administrator, who in person or through an agent ... transacts any business within the state ..." "In order to obtain jurisdiction under this statute, the following conditions must be met: (1) the defendant must transact business in the state; and (2) the cause of action must be directly related to, and arise from, the business so transacted." Storch v Vigneau, 162 AD2d 241, 242 (1st Dept 1990).

In determining whether a "transaction of business" has occurred "[t]he key inquiry is whether [the] defendant purposefully availed itself of the benefits of New York's laws." Courtroom Television Network v Focus Media, Inc., 264 AD2d 351, 353 (1st Dept 1999). The AG argues that Mcleod "transacted business" by maintaining eight active brokerage accounts with SSB in New York. See Memorandum of Law in Opposition to Motion, at 7-9. It is easy to see that, by opening and actively maintaining a brokerage account in New York, the account's owner gains both the protection of New York's banking and securities trading laws, and access to New York's banks and securities markets. Indeed, both New York State and federal courts have held that actively maintaining such an account constitutes "transacting business" within the statutory definition. See e.g. Ehrlich-Bober & Co., Inc. v University of Houston, 49 NY2d 574 (1980) (Acknowledging that defendant had "transacted business" pursuant to CPLR 302 (a) (1), and thereby subjected itself to the jurisdiction of the New York courts, by conducting 22 securities purchases - mainly by telephone - with New York brokerage firm); Deutsche Bank Securities, Inc. v Montana Bd. of Investments, 21 AD3d 90 (1st Dept 2005) (Jurisdiction lay under CPLR 302 (a) (2) where defendants' investment officer negotiated a single securities purchase with a New York-based bank via an internet instant messaging system); L.F. Rothschild, Unterberg, Towbin v

Thompson, 78 AD2d 795 (1st Dept 1980) (Non-domiciliary defendant, who only dealt with plaintiff securities broker by telephone and mail and never came to New York, held subject to personal jurisdiction pursuant to CPLR 302 (a) (1) because he sent checks and securities to New York and conducted 25 transactions in four months.); Credit Lyonnais Securities (USA), Inc. v Alcantara, 183 F3d 151 (2d Cir 1999) (Defendant "transacted business" in New York, within meaning of CPLR 302 (a) (1), where it maintained an "active account" with its New York-based securities broker and agreed to sell that broker various securities through that account); Newbro v Freed, 337 F Supp 2d 428 (SD NY 2004) (Personal jurisdiction lay under CPLR 302 (a) (1) where defendants maintained a brokerage account in New York and traveled there for meetings with the broker).

Nonetheless, McLeod argues that he:

> ... lived and worked in Iowa, his alleged 'failure to disclose' occurred in Iowa, the [SSB] broker through whom he purchased IPO shares worked in Los Angeles, and McLeod's financial advisor arranged for the share purchases by communicating from Iowa with McLeod's California-based broker.

See Defendant's Reply Brief in Further Support of Motion, at 2. He also cites the case of PaineWebber Inc. v Westgate Group, Inc. (748 F Supp 115 [SD NY 1990]) for the proposition that personal jurisdiction does not lie, pursuant to CPLR 302 (a) (1), where a defendant deals directly with a broker at the broker's office outside of New York. Id., at 3. PaineWebber Inc., which is not a state, but a federal case, does not stand for any such hard and fast rule. There, the District Court merely found that the Texas-based defendant that had engaged in "a series of frequent telephone calls and telecopies and ... one meeting during which a modification of [an] agreement was memorialized" had not "transacted business" in New York. The District Court

reiterated that "the focus of a C.P.L.R. § 302 inquiry is on what defendant ... did in New York in connection with the cause of action." PaineWebber Inc. v Westgate Group, Inc., 748 F Supp at 119. What the defendant did elsewhere is irrelevant. Here, the evidence shows that McLeod opened and maintained eight brokerage accounts with SSB in New York through which he traded millions of dollars worth of securities during the relevant time period. See Plaintiff's Statement of Facts in Opposition, Exhibit 37, ¶ 7; Exhibits 35, 36, 39, 40, 41. The agreements that McLeod signed with SSB to open those accounts clearly provide that New York State law shall govern any disputes between the parties that are submitted to arbitration, as well as the terms upon which any credit might be granted to McLeod in the future pursuant to a "margin agreement." Id., Exhibit 29. This evidence flatly contradicts McLeod's fanciful suggestion that SSB maintained those accounts in Los Angeles,[18] as does Trautenberg's admission that SSB's "personal wealth management" division conducted all of its clients' trades in New York. See Plaintiff's Statement of Material Facts (motion sequence number 004), Exhibit 14, at 44-46. McLeod also admits that he personally solicited authorization to purchase IPO stock from the CEO's of several companies that McLeodUSA did business with and that SSB was "taking public," and those CEOs have given corroborating testimony. Id., ¶¶ 114-130; Exhibits 1, 5, 10, 12, 33, 35, 36, 38, 39, and 42. After McLeod obtained those stock allocations, he traded them using his "personal wealth management" accounts in New York. Id. Finally, McLeod sought and received "margin loans" (i.e., lines of credit) from SSB totaling approximately $95 million for which he pledged his "spun"

---

[18] In his reply brief, McLeod asserts that his "brokerage relationship" was with Olson, who "lived and worked in Los Angeles." See Plaintiff's Reply Memorandum (motion sequence number 005), at 2. This is a meaningless statement. McLeod's only "brokerage relationship" was with SSB, the New York corporation that maintained his accounts and that employed Olson.

McLeodUSA stock as security. See Plaintiff's Statement of Material Undisputed Facts, ¶¶ 137-144; Exhibits 49, 50, 54. As previously mentioned, the rules governing McLeod's "personal wealth management" accounts provide that New York State law governs the terms upon which credit might be granted to McLeod pursuant to such "margin loans." See Plaintiff's Statement of Facts in Opposition, Exhibit 29.[19] The court finds that the foregoing activity amounts to "transactions of business" in New York within the statute's meaning.

Having made this determination, the next inquiry is whether "the cause of action [is] directly related to, and arise[s] from, the business so transacted." Storch v Vigneau, 162 AD2d at 242. New York State law requires "that a 'substantial relationship' must be established between a defendant's transactions in New York and a plaintiff's cause of action in order to satisfy the nexus requirement of the statute." Johnson v Ward, 4 NY3d 516, 519 (2005), quoting Kreutter v McFadden Oil Corp., 71 NY2d 460, 467 (1988). The causes of action at issue here are the Martin Act and Executive Law § 63 (12) claims, all of which allege that McLeod profited from participating in a fraudulent "stock spinning" scheme. The State argues that there is an articulable nexus between McLeod's active use of his "personal wealth management" accounts in New York and the causes of action against him for stock fraud. See Plaintiff's Memorandum of Law in Opposition to Motion, at 10-11. The State's brief also cites the federal District Court's decision in Newbro v Freed (337 F Supp 2d at 428) for the proposition that it is sufficient to show a "but for" relationship between the two in order to establish the requisite "articulable nexus." Id.

---

[19] In pertinent part, the rules state that the "[c]ustomer specifically agrees that credit shall be deemed to be extended in the State of New York and the legal rate of interest charges shall be governed by the State of New York and not by the state of [c]ustomer's residence (if different)." Id.

McLeod responds that there is no "but for" standard, and restates that the proponent of personal jurisdiction must establish a "substantial" connection. See Defendant's Reply Memorandum, at 4. McLeod is at least correct in his recitation of the law. Neither Newbro v Freed, nor any other case that the court could discover, holds that a "but for" standard is applicable when determining the existence of an "articulable nexus" for purposes of CPLR 302 (a) (1) jurisdiction.[20] However McLeod raises no factual argument, and the court can discern none, as to why the instant causes of action that allege stock fraud via participation in a "stock spinning" scheme are not "substantially" related to McLeod's active use of his "personal wealth management" accounts at SSB in New York, and his obtaining "margin loans" from SSB that were secured by his own inflated stock. It is, rather, abundantly clear that the instant causes of action are directly related to, and arise from, the "business" the McLeod "transacted" in New York. Accordingly, the court finds that both prongs of the jurisdictional analysis applicable to CPLR 302 (a) (1) have been met.

Having determined that the requirements of the New York State jurisdictional statute are satisfied, the court must inquire whether the exercise of personal jurisdiction also comports with the requirements of constitutional due process. See e.g. Bookstaver v Saintfort, 10 AD3d 514 (1st Dept 2004). The federal courts hold that:

> For due process to be satisfied, two requirements must be met. First, defendant must have "certain minimum contacts [with the forum] ··· such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." U.S. Titan, Inc. v Guangzhou Zhen Hua Shipping Co., 241 F3d 135, 152 (2d Cir 2001) (internal quotation marks omitted). Second, "the assertion of personal jurisdiction [must] comport [ ] with traditional notions of fair play and substantial justice - that is, ··· it [must be] reasonable under the

---

[20] The court also notes that neither Talbot v Johnson Newspaper Corp. (71 NY2d 827 [1988]), which McLeod cites, nor any other case that the court could discover, expressly rejects the use of a "but for" standard in the context of CPLR 302 (a) (1) either.

> circumstances of the particular case." Bank Brussels Lambert v Fiddler Gonzalez & Rodriguez, 305 F3d 120, 129 (2d Cir 2002) (internal quotation marks omitted).

Motorola Credit Corp. v Uzan, 274 F Supp 2d 481 (SD NY 2003). The "minimum contacts" portion of the analysis is satisfied where "a defendant's 'conduct and connection with the forum State' are such that it 'should reasonably anticipate being haled into court there'." LaMarca v Pak-Mor Mfg. Co., 95 NY2d 210, 216 (2000), quoting World-Wide Volkswagen Corp. v Woodson, 444 U S 286, 297 (1980). Such "reasonable anticipation" arises, in turn, where the defendant "'purposefully avails itself of the privilege of conducting activities within the forum State'." Id. The "traditional notions of fair play and substantial justice " portion of constitutional due process analysis requires a "reasonableness" balancing wherein:

> A court must consider the burden on the defendant, the interests of the forum State, and the plaintiff's interest in obtaining relief. It must also weigh in its determination 'the interstate judicial system's interest in obtaining the most efficient resolution of controversies; and the shared interest of the several States in furthering fundamental substantive social policies.'

Id. at 218, quoting Asahi Metal Indus. Co. v Superior Ct. of Cal., 480 US 102, 113 (1987).

The State's brief identifies the following as "purposeful" activities by McLeod: 1) his conducting hundreds of transactions through his eight New York-based SSB accounts; 2) his using the securities in his SSB accounts as collateral to obtain multi-million dollar loans from SSB's New York-based credit office; 3) his using New York-based SSB's brokerage services; and 4) his influencing the decisions of SSB's New York-based offices as to which "hot IPO" stock to allocate to him. See Plaintiff's Memorandum of Law in Opposition to Motion (motion sequence number 005), at 9. With respect to "traditional notions of fair play and substantial justice," the State argues that "the interests of New York in adjudicating the instant case are

strong, given that the case involves securities transactions that occurred in New York pursuant to an alleged agreement with a New York-based company." Id. at 11, fn 10. Unaccountably, McLeod fails to raise any constitutional due process arguments in any of his papers. The court makes the following findings.

The court has already determined that McLeod's activities constituted a "purposeful availment of the benefits of New York's laws" in holding that he "transacted business" here. The court now folds that McLeod's same activities were also "purposeful" as that term relates to the concept of "minimum contacts." McLeod's relationship with his New York investment bank involved his ownership of multiple "personal wealth management" accounts that are reserved for high net worth individuals and the receive special, personal attention and services from the bank. That relationship also involved not only millions of dollars worth of stock trades, but millions of dollars worth of personal loans that used that stock as collateral. Simply put, any individual who conducts that type and volume of investment banking business in New York should "reasonably expect to be haled into court" here. Therefore, the court finds that Mcleod has sufficient "minimum contacts" with New York that the exercise of personal jurisdiction over him here would not offend due process.

With respect to "traditional notions of fair play and substantial justice," the court notes that the AG's argument was legal rather than factual, and consisted solely of a citation to a case holding (contained in a footnote) and a request that the court observe the same logic. Although this would normally not be sufficient, "where a motion for summary judgment has been made, th[e] Court can search the record and grant summary judgment to any party ... ." Levin v 117 Limited Partnership, 291 AD2d 304 (1st Dept 2002), citing Merritt Hill Vineyards Inc. v Windy

Heights Vineyard, Inc., 61 NY2d 106 (1984). Here, the record shows that McLeod has conducted fairly frequent business trips to New York in the past and possesses considerable personal wealth, and that SSB has its primary business offices and business records in New York. See Plaintiff's Statement of Facts in Opposition to Defendant's Motion, Exhibits 2, 9, 10, 17. Thus, defending this action would place no undue burden on McLeod. On the other hand, the New York State legislature has clearly articulated a policy of aggressively policing and punishing stock fraud, as expressed by the its' passage of the Martin Act. Further, the "interstate judicial system" is not implicated in this action, since McLeod is obviously not being prosecuted under the Martin Act by any other state. If any other states did seek to prosecute him for securities fraud, however, this court would deem their interests in doing so to be subordinated to New York's, given New York's unique role as a global financial center. Therefore, the court finds that obliging McLeod to defend this action in New York does not offend "traditional notions of fair play and substantial justice." Accordingly, the court holds that its exercise of personal jurisdiction over McLeod comports with principles of constitutional due process. Because the court has already determined that the requirements of CPLR 302 (a) (1) are satisfied, it concludes that it is proper to exercise personal jurisdiction over McLeod in this case. Accordingly, the court denies the branch of McLeod's motion that seeks summary judgment dismissing the complaint for lack of such jurisdiction.

2. McLeod Did Not Commit Fraud

In the next portion of his motion, McLeod raises a number of arguments that his non-disclosures were neither fraudulent not material. See Memorandum of Law in Support of Motion (motion sequence number 005), at 8-20. These are the exact same arguments that McLeod raised

in opposition to the State's motion. The court has already considered and rejected each of those arguments. Accordingly, the court denies the portion of McLeod's motion that seeks summary judgment dismissing the complaint on the ground that he did not commit fraud.

3. The AG's Consumer Protection Act and Unjust Enrichment Claims Are Legally Deficient

McLeod next argues that the State's Consumer Protection Act and unjust enrichment claims must fail as a matter of law. See Memorandum of Law in Support of Motion (motion sequence number 005), at 21-23. The former claim refers to the fifth cause of action, which alleges that McLeod committed "deceptive acts and practices" in violation of General Business Law § 349. The State did not initially seek summary judgment on that cause of action. Now, in its opposition to McLeod's motion, the State avers that the Consumer Protection Act claim is withdrawn. Accordingly, the court grants McLeod summary judgment dismissing the fifth cause of action on consent.

With respect to the cause of action for unjust enrichment, the court has already denied the State's motion for summary judgment. As previously stated, that claim is unsustainable because the court has found that any "benefit" that the plaintiffs in this action conferred upon McLeod was too remote to support such a claim. Accordingly, the court also grants McLeod summary judgment dismissing the fourth cause of action.

4. The State May Not Seek a Monetary Remedy Against McLeod

McLeod's final argument is that the State has no legal authority to seek a monetary remedy against him. See Memorandum of Law in Support of Motion (motion sequence number 005), at 23-30. The first branch of this argument asserts that the State may not seek restitution as a remedy for the Martin Act claims because there is no proof of what amounts - if any - of

McLeod's revenues could be ascribed to his fraudulent activity. Id. at 23-24. McLeod's conclusion that the State may not seek restitution for this reason is blatantly incorrect. Gen. Bus. Law § 353 (3) specifically provides that:

> Upon a showing by the attorney general that a fraudulent practice as defined by this article has occurred, he may include in an action under this article an application to direct restitution of any moneys or property obtained directly or indirectly by any such fraudulent practice.

However, McLeod correctly notes that in People ex rel. Vacco v Appel (258 AD2d 957 [1st Dept 1999]), the Appellate Division, First Department, found that the trial court had abused its discretion by granting the plaintiff a summary judgment that ordered the defendant to make full restitution of all of its profits. The Appellate Division found that the trial court should have conducted a hearing on the issue of how much of those profits could be ascribed to the defendant's fraud, and remanded the case for such a hearing. This appears to be the correct procedure to follow. See e.g. People ex rel. Vacco v World Interactive Gaming Corp., 185 Misc2d 852 (Sup Ct NY County 1999); People v Barrington & Co., 137 NYS2d 54 (Sup Ct NY County 1954). Accordingly, the court rejects this branch of McLeod's dismissal argument, but finds that a hearing is necessary on the amount of restitution that he must pay, and modifies its grant of summary judgment to the State on its Martin Act causes of action to require such a hearing.

The next branch of McLeod's argument asserts three reasons why the State is not entitled to collect money damages as a remedy for the Executive Law § 63 (12) claim. See Memorandum of Law in Support of Motion (motion sequence number 005), at 24-25. The first of these is that the complaint fails to plead most of the damage claims. Id. at 25. McLeod argues that the four

types of money damages that are specified in the States' expert reports[21] are unavailable: 1) because they were not previously specified in the complaint, and McLeod therefore had no notice that he would have to defend against such damage claims; and 2) because they are based on unpled causes of action for "self dealing, usurpation of corporate opportunity, and/or wasting corporate assets." Id. The State responds that these arguments are "disingenuous." See Plaintiff's Memorandum of Law in Opposition to Motion (motion sequence number 005), at 24. The court agrees. With respect to McLeod's first assertion, the court is aware of absolutely no authority that supports the proposition that the State is limited to the whatever amounts of damages are specified in the original complaint when prosecuting an Executive Law § 63 (12) claim. McLeod's cite to Barr v Country Motor Car Group, Inc. (15 AD3d 985 [4th Dept 2005]) provides no such authority because it is an out of context quote from a commercial landlord and tenant case that has no bearing on this action. With respect to McLeod's second assertion, the court has already rejected his argument that the instant causes of action are actually private claims in disguise. The court now does so again, and rejects McLeod's "unpled damages" argument in full.

McLeod next argues that money damages are unavailable: 1) because the claims that the State sues upon actually belong to McLeodUSA, and McLeodUSA has already discharged its

---

[21] The four types of money damages that are specified in the State's expert reports include: 1) the amounts representing the "first day gain" realized on the IPO shares that McLeod purchased through SSB; 2) the amounts lost through the "excessive underpricing" of McLeodUSA's IPO; 3) the amounts representing the difference between the fees that McLeodUSA actually paid to SSB and the fees that McLeodUSA would have paid to SSB had McLeod disclosed his receipt of IPO shares; and 4) the amounts representing the "inflation of share prices resulting from biased analyst coverage" of the IPO stock that McLeod purchased through SSB.

claims against McLeod in bankruptcy; and 2) because the AG lacks parens patriae authority to proceed on behalf of a corporation such as McLeodUSA. See Memorandum of Law in Support of Motion (motion sequence number 005), at 25-27. The court has already considered and rejected these arguments, and now does so again for the reasons stated earlier in this decision.

Finally, McLeod argues that the claim for money damages that are calculated on the theory of "inflation of share prices resulting from biased analyst coverage" must fail because the State has failed to demonstrate "loss causation." See Memorandum of Law in Support of Motion (motion sequence number 005), at 28-30. McLeod cites the recent decisions by the U. S. Court of Appeals for the Second Circuit in Lentell v Merrill Lynch & Co., Inc. (396 F3d 161 [2d Cir 2005]), and by the Appellate Division, First Department, in Laub v Faessel (297 AD2d 28 [1st Dept 2002]), to support his argument. However, the former decision dealt with a claim that the defendant had violated federal securities laws, while the latter dealt with common-law claims that the defendant had committed fraud, negligent misrepresentation and breach of fiduciary duty. Neither decision dealt with a claim for violation of Executive Law § 63 (12). Because "loss causation" is not an element of such claims, the court rejects McLeod's final legal argument as meritless. Accordingly, the court finds that McLeod's motion for summary judgment should be granted in part and denied in part.

DECISION

ACCORDINGLY, for the foregoing reasons, it is hereby

ORDERED that the motion, pursuant to CPLR 3212, of the plaintiff State of New York and Attorney General Eliot Spitzer, acting on behalf of the People of the State of New York, is

granted in favor of the plaintiff and against the defendant, Clark E. McLeod, solely to the extent of granting the plaintiff partial summary judgment on the issue of liability on the first, second, third and sixth causes of action that are set forth in the second amended complaint, with the issue of the amount of money damages due - if any - to be resolved at a separate hearing, and is in all other respects denied; and it is further

ORDERED that the motion, pursuant to CPLR 3212, of defendant Clark E. McLeod is granted in favor of the defendant and against the plaintiff solely to the extent of granting the defendant partial summary judgment dismissing the fourth and fifth causes of action in the second amended complaint, and is in all other respects denied; and it is further

ORDERED that a copy of this order with notice of entry be served upon the Clerk of the Trial Support Office (Room 158), who is directed, upon the filing of a note of issue and a statement of readiness and the payment of proper fees, if any, to place this action on the appropriate trial calendar for the hearing on damages hereinabove directed.

Dated: New York, New York
February 9, 2006

ENTER:

____

Hon. Richard B. Lowe, J.S.C.