

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE NETBANK, INC.
SECURITIES LITIGATION

CIVIL ACTION FILE
NO. 1:07-CV-2298-BBM

ORDER

This matter is before the court on the Motion to Dismiss the Consolidated and Amended Class Action Complaint [Doc. No. 40], filed by Defendants Steven F. Herbert, Douglas K. Freeman, James P. Gross, Thomas H. Muller, Jr., Eula L. Adams, and David W. Johnson, Jr. (“Defendants”).

I. Factual and Procedural Background¹

On a motion to dismiss, the court accepts as true all factual allegations set out in the Plaintiffs’ Complaint. See Lotierzo v. Woman’s World Med. Ctr., Inc., 278 F.3d 1180, 1182 (11th Cir. 2002).

The present case is brought by certain shareholders of NetBank, Inc. (“NetBank” or the “Company”) alleging violations of federal securities laws §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 10b-5 promulgated thereunder. The Plaintiffs, individuals who purchased or acquired

¹Except as otherwise noted, the following facts are taken from the Consolidated and Amended Class Action Complaint, and do not constitute findings of fact by the court.

NetBank common stock from March 16, 2005 to May 21, 2007, allege that Defendants defrauded them “by making materially false and misleading statements and omissions regarding the financial results, operations and condition of the Company, which artificially inflated the price of NetBank common stock during the Class Period.” (Am. Compl. ¶ 3.) Plaintiffs state that had they known the truth about NetBank, they would not have purchased or acquired the securities either in general or at the artificially inflated prices, and suffered damage as a result of their purchases.

NetBank was founded in 1996 as a financial holding company operating a number of businesses focused primarily on consumer and small business banking. In addition to its core banking business, it owned a number of subsidiaries including NetBank, FSB (a federal savings bank); MG Reinsurance Company (a captive reinsurance company); NetInsurance, Inc. (a licensed insurance agency); and NB Partners, Inc. (a corporation involved in strategic partnering opportunities). NetBank FSB in particular was recognized as one of the first successful internet-only banks. In 1997, NetBank’s stock began trading on the NASDAQ securities exchange. A decade later, the Company had 46,425,000 outstanding shares as of February 21, 2007.

In 2002 NetBank acquired Resource Bancshares Mortgage Group (“RBMG”), a wholesale mortgage backing company, as well as its sub-prime mortgage subsidiary, Meritage Mortgage Corporation. In connection with this transaction, RBMG’s Chief Executive Officer and its Chief Financial Officer, Messrs. Freeman and Herbert, took on these same positions with the post-acquisition NetBank. NetBank subsequently sought to expand its banking business by engaging in mortgage lending and servicing, speciality lending, and transaction processing businesses. As part of the mortgage lending operation, NetBank issued mortgages, thereby earning interest and fees on those, as well as profits on the sale of the mortgage loans or its mortgage backed securities.

For the 2003 fiscal year, NetBank reported a net income of \$50.14 million and a share price of approximately \$1.04/share. In a subsequent Form 10-K for the fiscal year ending 2004, the Company represented that its net income for the period was \$4.22 million or \$.09/share. This filing also included a description of NetBank’s restructuring efforts designed to improve the Company’s earnings, including investing in mortgage loans. Thereafter NetBank’s share price increased, and during a May 4, 2005 conference call with investors, Mr. Freeman reported that such efforts had been effective. Part of this call also pointed out the improvements in performance NetBank had made during the past two years. The Company’s stock

price subsequently rose from \$8.38/share on May 2, 2005 to \$8.53/share on May 4, 2005.

By 2006 however, the U.S. housing bubble had burst, and banks and other institutions faced exposure from sub-prime and other mortgage practices. On May 1, 2006, NetBank made public representations that it was restructuring its operations to eliminate high-risk non-conforming loan origination operations and other failing business segments. NetBank likewise stated that its core banking business would substantially benefit by eliminating these operations. On October 13, 2006, NetBank issued a press release reporting that it had sold the servicing rights on \$8.5 billion of mortgages. The Company sustained a \$19.3 million loss on the transaction. However NetBank simultaneously reassured investors that it would no longer have the same level of exposure to impairment and hedge-related losses, and upon such news its stock price rose from \$6.11/share on October 13, 2006 to \$6.17/share on October 16, 2006.

On November 9, 2006, NetBank informed the public that its outside auditor, Ernst & Young, would be resigning after NetBank filed its Form 10-Q for the third quarter of 2006. This filing would prove to be the last the Company made with the Securities and Exchange Commission ("SEC"). However at the time of releasing this information, NetBank stated that the resignation was not due to material

disputes between the two companies. On February 16, 2007, NetBank announced that it had retained a new outside auditor to take the place of Ernst & Young, assuring investors that the filing of its 2006 annual report would only be delayed by the transition. On February 21, 2007, Netbank revealed a loss in excess of \$86 million for the previous quarter. On May 1, 2007, the Company issued a press release announcing that it had sold two of its side operations for \$18 million, which was portrayed as a “win-win” that had increased NetBank’s tangible book value.

NetBank then informed the public on May 21, 2007, that its core banking business was “highly deficient” and that it had failed to meet its regulatory capital requirements. (Am. Compl. ¶ 11.) It stated that as a result, banking regulators were mandating NetBank sell: (1) \$2.5 billion of its core and brokered deposits; (2) its held for investment loan portfolio; (3) the assets and liabilities of NetBank Business Finance (the business financing division of NetBank FSB); (4) NetBank’s small business equipment leasing and financing operation; and (5) the NetBank brand and related trademarks and service marks. The net result of these sales was expected to yield a \$60-70 million loss to NetBank. Because of these disclosures, the price of NetBank’s common stock fell from \$1.75/share on May 18, 2007 to \$.59/share on May 21, 2007.

On August 6, 2007, NetBank filed a Form 8-K with the SEC reporting that the entire carrying amount of goodwill for its wholly-owned retail mortgage business, Market Street, would have to be written off. This impairment reduced the Generally Accepted Accounting Principles ("GAAP") net worth of the Company by \$24.6 million. Due to NetBank's failure to file required financial reports with the SEC, the NASDAQ de-listed the Company's stock on August 7, 2007. Three days later, on August 10, 2007, NetBank filed a Form 12b-25 which reported that Ernst & Young had withdrawn its audit opinions for the Company's prior Forms 10-K for 2004 and 2005. The 12b-25 said that the audit opinions were withdrawn because of NetBank's misapplication of Statement of Financial Accounting Standard ("FAS") 133, and included a statement that investors "should no longer rely on NetBank's financials." (Am. Compl. ¶ 14.) NetBank likewise stated that it had withheld information that the SEC had been investigating its accounting practices since August 31, 2006 (almost one year earlier). As of September 17, 2007, the sale of NetBank's assets which had been announced on May 21, 2007 had fallen through, and on September 28, 2007, federal regulators from the Office of Thrift Supervision shut down NetBank's operations. That same day, NetBank filed a voluntary petition for bankruptcy.

Two separate Complaints were filed against NetBank during the Fall of 2007, both alleging that the Company's ongoing representations were fraudulent on account of the non-disclosure of (1) the failure of NetBank's core operations and (2) the fact that the sale of the non-conforming mortgage business would be insufficient to sustain the Company. On April 21, 2008, this court issued an Order consolidating the two cases and selecting Robert A. Brown ("Mr. Brown" or "Plaintiff" or "Lead Plaintiff"), to serve as the lead plaintiff.

On July 3, 2008, Mr. Brown, individually and on behalf of all other persons similarly situated who purchased or acquired NetBank common stock from March 16, 2005 to May 21, 2007 (the "Class Period"), filed a Consolidated and Amended Class Action Complaint ("Complaint" or "Amended Complaint"). The Complaint named as Defendants certain NetBank senior officers and directors, including Steven F. Herbert, Douglas K. Freeman, James P. Gross, Thomas H. Muller, Jr., Eula L. Adams, David W. Johnson, Jr., and Catherine A. Ghiglieri ("Ms. Ghiglieri") (collectively the "Defendants"). Because NetBank has filed a petition for bankruptcy under Chapter 11 of the federal bankruptcy laws, which filing operates as an automatic stay on judicial proceedings against the debtor, NetBank was not named as a Defendant in the Amended Complaint. See 11 U.S.C. § 362(a) (2006).

The Amended Complaint lists two bases for relief: (1) violation of § 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder; and (2) violation of § 20(a) of the Exchange Act. Mr. Brown subsequently dismissed the claims against Ms. Ghiglieri on September 12, 2008. Three days later, on September 15, 2008, the remaining Defendants filed the present Motion to Dismiss the Consolidated and Amended Class Action Complaint.

II. Legal Standard

Under Federal Rule of Civil Procedure 12(b)(6), a court may grant a motion to dismiss when a complaint fails to state a claim upon which relief can be granted. To withstand a motion to dismiss, a complaint need not contain “detailed factual allegations,” but must “‘give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.’” Bell Atl. Corp. v. Twombly, 550 U.S. 544, 127 S. Ct. 1955, 1959 (2007) (quoting Conley v. Gibson, 355 U.S. 41, 47 (1957)). Here, the court must determine whether the Plaintiffs “ha[ve] alleged enough facts to suggest, raise a reasonable expectation of, and render plausible” their claims. Watts v. Fla. Int’l Univ., 495 F.3d 1289, 1296 (11th Cir. 2007). The court construes the Complaint in the Plaintiffs’ favor, and accepts the facts they allege as true. M.T.V. v. DeKalb County Sch. Dist., 446 F.3d 1153, 1156 (11th Cir. 2006). However, “a formulaic recitation of the elements of a cause of action will not do.” Twombly, 127 S. Ct. at

1964-65. Thus, a wholly conclusory statement of a claim cannot, without more, survive a motion to dismiss. See Weissman v. Nat'l Ass'n of Sec. Dealers, Inc., 500 F.3d 1293, 1303 (11th Cir. 2007) (citing Twombly, 127 S. Ct. at 1968).

III. Analysis

In order to state a claim under § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, a plaintiff must allege: “(1) a false statement or omission of material fact (2) made with scienter (3) upon which the plaintiff justifiably relied (4) that proximately caused the plaintiff's injury.” Robbins v. Kroger Props., Inc., 116 F.3d 1441, 1447 (11th Cir. 1997). Both parties agree that the Plaintiffs’ claims are subject to “heightened pleading requirements” under the Private Securities Litigation Reform Act of 1995 (“PSLRA”). (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 8; Mem. of Law in Opp’n to Defs.’ Mot. to Dismiss 12.) However they disagree about whether the Plaintiffs have adequately alleged facts as to each of the above elements that are sufficient to support the claims for securities fraud.

A. False Statements of Material Fact

In a private securities litigation case, “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. § 78u-4(b)(1). Defendants make two separate arguments regarding the false statement of material fact requirement, and the court will address each in turn.

1. Clear Identification of Challenged Statements

Defendants first argue that the Complaint “makes it impossible to tell exactly which statements Plaintiffs contend were false or misleading and why.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 11.) They reason that because Plaintiffs fail to clearly identify the challenged statements, the Amended Complaint should be dismissed.

In support of the fraud claim, Plaintiffs allege in part that “NetBank claimed to have . . . a set of strong internal controls to reduce the risk inherent for its own ‘non-conforming’ loan business.” (Am. Compl. ¶ 86.) In identifying misleading statements, the Complaint lists language from the 2000 Annual Report, in which the Company ensured investors that its “discipline” in managing assets was second to none, and that unparalleled scientific and mathematical approaches were used to determine the optimal conditions for selling loans, allowing the Company to “appropriately” manage its risk. (*Id.*) Likewise, Plaintiffs allege that “throughout the Class Period, Defendants continued to claim that NetBank maintained strong internal controls to reduce the risk associated with its loan business.” (*Id.* ¶ 87.) As

a further example of a misleading statement, Plaintiffs provide an excerpt from NetBank's Form 10-K for 2005, which repeatedly cited the Company's "quality control program" as a "significant element[]" in its efforts to purchase high-quality mortgage loans and servicing rights. (Id.) To meet the requirement of pleading the reason the statement is misleading, the Complaint alleges that "such assurances were exposed to be false," and provides supporting language from the federal Office of Thrift Supervision's press release specifically attributing NetBank's demise to "weak underwriting," "poor documentation," and "a lack of proper controls." (Id. ¶ 88.) Taking these and other statements to be true, and construing all allegations in a light most favorable to Plaintiffs, the court finds they have satisfied the first statutory requirement that the Complaint identify particular statements alleged to be misleading as well as explain why they are misleading.

2. Particularized Fraud Allegations

Defendants next argue that Plaintiffs have failed to support the fraud claims "with particularized factual allegations." (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 12.) The court will now analyze each of Defendants' arguments made on this ground.

a. NetBank's Core Banking Business

Defendants first take issue with Plaintiffs' allegations that the Defendants defrauded investors by failing to disclose that NetBank's financial distress was due to the failure of its core operations. In support of their Motion to Dismiss, Defendants argue that NetBank's demise was not due to the retail banking segment but rather was a product of "a faltering housing market and the resultant damage to mortgage lending operations." (Id. at 13-14.) Defendants go on to say that there is "no factual support for the contention that Defendants misled investors by 'failing to disclose' that the 'core banking business was . . . highly deficient,' or 'that selling parts of its mortgage business or other non-core operations would not be enough to resuscitate the Company.'" (Id. at 14.) To further this argument, Defendants point to language in the Complaint they say affirmatively shows NetBank disclosed the poor performance of its retail banking segment during the Class Period. Defendants lastly argue that the allegations in the Complaint "do not support Plaintiff's claim that Defendants misrepresented the viability [of] NetBank's retail banking operations." (Id. at 15.) Defendants complete their argument by stating that "losses from mortgage banking operations were the primary cause of the Company's undoing." (Id.)

Although proffered as an argument about the particularity of the factual allegations, Defendants essentially argue that the allegations in the Amended Complaint cannot possibly be true and therefore the claims should be dismissed. In part, they attempt to support the arguments regarding the validity of some of the language from the Complaint with other language from the Complaint itself. However, the court is mindful that “court determinations of facts and factual disputes have no place in a motion to dismiss.” Shahar v. Bowers, No. 1:91-CV-2397-RCF, 1992 WL 220781, at *2 n.4 (N.D. Ga. Mar. 6, 1992) (Freeman, J.) (citation and internal quotations omitted). Likewise, the Supreme Court has set out prescriptions for courts faced with a Rule 12(b)(6) motion to dismiss an action governed by the PSLRA, one of which specifically reads: “courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, *accept all factual allegations in the complaint as true.*” Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 127 S. Ct. 2499, 2509 (2007) (emphasis added). The court is therefore unwilling and unable to make a determination as to the truth of certain facts as alleged in the Complaint, and Defendants’ Motion to Dismiss must fail on this basis.

In conjunction with the above arguments, Defendants also argue that Plaintiffs’ allegations made in reliance upon various “confidential witness[es] . . .

fall[] far short of supply the factual particularity required to state a fraud claim.”

(Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 15-16.)

When plaintiffs rely on confidential personal sources but also on other facts, they need not name their sources if the pleaded facts provide an adequate basis for believing that the defendants’ statements were false. Even if personal sources must be identified, they need not be named provided they are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged.

2 James Wm. Moore et al., Moore’s Federal Practice § 9.03[6][a][i] (3d ed. 2008).

Defendants argue that the Amended Complaint is insufficient because it “alleges no facts explaining how the Defendants, or indeed the ‘confidential witness,’ could predict the OTS’s decision to close the Bank months before that decision was made.”

(Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 15-16.) However Defendants have pointed to no legal requirement that Plaintiffs allege facts regarding how the Defendants or confidential witnesses obtained knowledge that the Office of Thrift Supervision would close NetBank. In any event, the Complaint does give sufficient information to support a presumption that a person in the position of the source would have the information alleged. For example, paragraph 218 states that the confidential witness “was a senior executive officer of NetBank during most of the Class Period . . . who had direct daily contact with the top executive officers.” (Am. Compl. ¶ 218.) Another portion of the Complaint likewise provides detail that the

confidential witness at issue “was a senior corporate officer of NetBank . . . who provided input directly to defendants Freeman, Herbert, and Gross.” (Id. ¶ 219.) As such, dismissal is not appropriate on this ground. Because Defendants raise no other legitimate and related bases for dismissal on account of the particularity of the fraud allegations surrounding NetBank’s core banking business, the court finds that dismissal is not warranted.

b. Ernst & Young’s Resignation

Defendants next argue that Plaintiffs’ “Complaint also fails adequately to allege material misrepresentations or omissions regarding E&Y’s resignation.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 16.) They claim that only Ernst & Young, and no one else, can confirm or deny whether NetBank accurately stated Ernst & Young’s position upon its resignation. (Id. at 16-17.) Defendants also argue that because the Plaintiffs have alleged no motive for Ernst & Young to misrepresent the circumstances of its resignation, the claim must be dismissed. Finally, they argue that none of the allegations in the Complaint show the falsity of the challenged statement, and as such fail. (Id. at 17.)

As discussed above, this court may not inquire into the truthfulness of Plaintiffs’ allegations at this stage, nor engage in the process of weighing the credibility of those allegations. See supra, Part III(A)(2)(a). Defendants provide no

legal basis upon which this court may require Plaintiffs to allege motive as part of any misrepresentation regarding the Ernst & Young resignation in connection with the claim for fraud against individuals associated with NetBank. Lastly, the pleading requirement under the PSLRA is merely that the Complaint give “the reason or reasons why the statement is misleading.” 15 U.S.C. § 78u-4(b)(1). The portions of Plaintiffs’ Complaint that Defendants cite satisfy this requirement. For example, paragraph 157 lists one supporting reason to believe NetBank’s 2006 Form 8-K was false as the presence of “a significant ongoing disagreement” between Ernst & Young and NetBank “regarding the calculation of the Company’s hedge effectiveness under SFAS 133.” (Am. Compl. ¶ 157.) Support for this allegation comes from a confidential witness who was a senior executive of NetBank and who had regular daily interaction with defendants Freeman, Herbert, and Gross. Additionally, paragraph 160 alleges that Ernst & Young told NetBank that it was resigning because “it was not comfortable with the Company’s financial statements.” (*Id.* ¶ 160.) Taken as true, these and other allegations satisfy Plaintiffs’ burden of supplying reasons how the Form 8-K was misleading, and as such dismissal is not appropriate on this ground.

c. Accounting Misstatements

Defendants also argue that the Plaintiffs' Complaint fails to allege with adequate particularity misstatements or omissions regarding NetBank's financial statements or accounting. Each of the Defendants' five arguments are discussed below.

(1) Book Value

Defendants make two arguments about Plaintiffs' allegations that NetBank made false assurances to investors that they could rely on the Company's book value. First, Defendants say dismissal is proper because Plaintiffs do not "identify a single statement purporting to assure investors that they could rely on the Company's reported book value." (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 18.) "Reliance is one of the elements that must be proven by a party charging fraud, and the reliance must be reasonable under the circumstances." Intercorp, Inc. v. Pennzoil Co., 877 F.2d 1524, 1530 (11th Cir. 1989). The court understands that reliance on the part of the aggrieved party is required to establish fraud. However, Defendants have not provided support for, and the court is not otherwise aware of any additional element requiring express or explicit statements promising the soon-to-be-injured party that he or she can rely on statements by the speaker. Under the circumstances here, where NetBank: (1) held conference calls with analysts to

discuss the Company's financial results; (2) made assurances to investors while announcing a plan to sell its mortgage servicing platform; (3) issued press releases; and (4) publicly announced operating results, the court finds that reliance by stockholders on such statements would have been reasonable under the circumstances. (Am. Compl. ¶¶ 144-50.) Because shareholders routinely and reasonably rely on such representations, dismissal based on Defendants' arguments about the sufficiency of the allegations of reliance is not appropriate.

Second, Defendants argue that Plaintiffs' Complaint fails because it does not provide factual support for its assertion that NetBank failed to disclose that the Company's tangible book value was declining rapidly. In conjunction with this argument, Defendants state that this allegation cannot possibly be true, as the Complaint "confirms that NetBank disclosed declines in book value." (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 18.) Again, the court will not weigh the credibility of Plaintiffs' allegations at this stage.² See supra, Part III(A)(2)(a).

²In light of the number of times it has been necessary to recite that it is not appropriate for the court to weigh evidence at the motion to dismiss stage of litigation, the court will go ahead and remind Defendants that neither is it appropriate for the court to weigh evidence at the summary judgment stage of a proceeding. Anderson, 477 U.S. at 249 ("[I]t is clear enough from our recent cases that at the summary judgment stage the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial."). Defendants are DIRECTED to avoid this type of argument in seeking a judgment pursuant to Fed. R. Civ. P. 56.

(2) Loan Loss Reserves

Defendants next argue that Plaintiffs fail to plead material misstatements or omissions concerning loan loss reserves. Their first argument is that “allegations merely charging that reserves ultimately proved inadequate fail to state a federal securities fraud claim.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 19.) However Defendants minimize the substance of Plaintiffs’ Complaint. In fact, the Complaint alleges that NetBank *knew* its underwriting guidelines were insufficient, and that the reserves that it knew or should have known were necessary were not in place. (Am. Compl. ¶ 279.) It continues by alleging that NetBank’s *own* analysis prior to 2005 showed its reserves needed to be in the range of 1 to 3 basis points, and for 2005 and beyond, the Company’s analysis showed it needed to increase its reserves to between 12 and 14 basis points. (Id.) The Complaint alleges, notwithstanding such knowledge that NetBank’s “own analysis indicated that its reserves were severely deficient,” Defendant Herbert stated in an August 3, 2005 conference call with analysts: “[A]s soon [as] we become aware of a loan in a problem, we allocate reserves to it.” (Id. ¶ 281.) As this is not a mere allegation that the Company’s reserves ultimately proved to be inadequate after the fact, dismissal on this ground is not appropriate.

Defendants also claim that Plaintiffs have failed to allege facts demonstrating that “particular loan loss reserves were inadequate based on information available to NetBank when the reserves were set.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 20.) They argue that Plaintiffs, “with the benefit of hindsight,” insist that Defendants should have made more accurate predictions regarding loan losses. (Id.) However, in light of the court’s previous discussion concerning Plaintiffs’ allegations about loan loss reserves, the court finds this argument to be unpersuasive and dismissal on this basis likewise inappropriate.

Finally, Defendants argue that Plaintiffs’ Complaint should be dismissed because the allegations in part are based on loan loss reserves, which are forward looking statements protected by the PSLRA’s safe harbor provision.³ (Id.) “Under

³The safe harbor provision reads:

(1) In general

Except as provided in subsection (b) of this section, in any private action arising under this chapter that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) of this section shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that--

(A) the forward-looking statement is--

(i) identified as a forward-looking statement, and is

the PSLRA's safe harbor, 'forward-looking statements' are protected by requiring a plaintiff to raise a strong inference that defendants made forward looking statements with 'actual knowledge' they were 'false or misleading' to establish liability." Carpenters Health & Welfare Fund v. Coca-Cola Co., No. 1:00-CV-02838-WBH, 2002 WL 34089163, at *19 (N.D. Ga. Aug. 20, 2002) (Hunt, J.) (citing 15 U.S.C. § 78u-5). First, even assuming the provision applies, the face of the

accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

(ii) immaterial; or

(B) the plaintiff fails to prove that the forward-looking statement--

(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

(ii) if made by a business entity; was--

(I) made by or with the approval of an executive officer of that entity; and

(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

15 U.S.C. § 78u-5(c) (footnote omitted).

Complaint appears to comply with the heightened pleading requirement for forward-looking statements. In any event, because this case is still at the Motion to Dismiss stage, “the Court concludes that it would be imprudent at this juncture to grant Defendants' Motion to Dismiss based on the safe harbor provision.” *Id.* at *20. Accordingly, dismissal will not be granted on this ground.

(3) Asset Impairments

Defendants next argue that Plaintiffs' allegations fail because they are merely conclusory statements challenging the timing of asset write downs, and are non-actionable as “fraud by hindsight.” (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 21.) They state that because no particular facts have been alleged showing that any announcements of impairments were untimely delayed, these claims should be dismissed.

First, a number of allegations in the Complaint identified by Defendants do not relate to challenging the timing of the asset write downs. For example, paragraph 139 discusses a press release issued by NetBank that described the Company's recording of an after-tax loss of \$8.7 million on the sale of securities, in the context of total after-tax expenses of \$28.1 million. The accompanying allegation in paragraph 141, however, asserts NetBank “failed to disclose . . . that the Company's accounting for its mortgage business was improper and . . . that the SEC

had challenged the Company's improper accounting treatment." (Am. Compl. ¶ 141.) The allegation relates not to the timing of the loss itself, but to NetBank's *actual disclosure* of its accounting practices. Likewise, paragraph 195 of the Complaint discusses how NetBank issued a May 1, 2007 press release announcing that it would record an impairment of approximately \$2.0 million. Yet the related allegation claims fraud because NetBank "failed to disclose that the Company's tangible book value in fact continued to decline rapidly even with the restructuring and multiple cash infusions." (*Id.* ¶ 197.) As neither of these allegations relate to NetBank's improper timing of asset write downs, their dismissal is inappropriate.

It is well-established that "mere allegations that statements in one report should have been made in earlier reports do not make out a claim of securities fraud." In re Serologicals Sec. Litig., No. Civ.A.1:00-CV1025CAP, 2003 WL 24033694, at *10 (N.D. Ga. Feb. 20, 2003) (Pannell, J.) (citation and internal quotations omitted). By the same token, dismissal is not called for simply because an allegation claims that statements should have been disclosed in earlier reports. "Rather, the standard is whether the need to write-down . . . was so apparent to the defendants before the announcement, that a failure to take an earlier write-down amounts to fraud." *Id.* (citation and internal quotations omitted). The distinction

is that merely “[s]eizing on figures later used in financial statements exemplifies pleading fraud by hindsight, an impermissible method of pleading fraud.” Id.

Defendants next point to Plaintiffs’ allegation of Defendants’ failure to timely recognize goodwill impairment losses as warranting dismissal. However this is not a conclusory allegation lacking support that argues losses should have been recognized earlier, nor is it based solely on figures from a subsequent financial statement. In this claim, Plaintiffs allege that Defendants *knew* they had losses in their representations and warranties liability. (Am. Compl. ¶ 300.) They allege that despite this knowledge, Defendants issued financial statements that failed to timely recognize impairment losses from NetBank’s non-conforming loan operations. Had these losses been properly recognized, they would have been an indication that “the fair value of the Company’s non-conforming loan operations had been reduced below its carrying value, thereby requiring an evaluation of goodwill impairment resulting in the timely recognition of impairment losses.” (Id. ¶ 302.) However, Plaintiffs claim that because Defendants disregarded known losses in their representations and warranties liability, and disregarded signs that goodwill had been impaired, they avoided timely recognizing the impairment losses. (Id.) The claim survives dismissal because Plaintiffs provide adequate support for their claim that NetBank failed to timely record asset impairments.

Finally, paragraphs 314 to 316 of the Complaint allege that Defendants failed to “timely recognize known losses regarding the impairment of its MSR’s (mortgage servicing rights assets).” (*Id.* ¶ 316.) In support of this claim, Plaintiffs allege that Defendants *knew* agency eligible loans⁴ included the Company’s other non-traditional loans, and also had knowledge that market conditions, such as the decline in home values, had significantly decreased the fair value of its MSR’s. They claim that despite this knowledge, Defendants “disregarded the significant indications of the impairment of its MSR’s and avoided timely recognizing the related known impairment losses.” (*Id.* ¶ 314.) The court finds that Plaintiffs have also satisfied the pleading requirement for this claim relating to NetBank’s failure to timely record asset impairments, and dismissal is likewise not appropriate.

(4) FAS 133

Defendants next argue that Plaintiffs’ claim that NetBank misled investors regarding the validity of its FAS 133 accounting merits dismissal because “Plaintiff alleges no factual support whatsoever for the claim that NetBank’s application of FAS 133 caused the Company’s accounting for its mortgage operations to be

⁴The Complaint sets out Defendants’ description of “agency-eligible loans” as being “those mortgage loans that meet the size, documentation, borrower and credit standards to qualify to be pooled into mortgage-backed securities guaranteed by government sponsored enterprises, such as Fannie Mae, Freddie Mac and Ginnie Mae.” (Am. Compl. ¶ 313.)

materially misstated.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 22-23.) Defendants likewise argue that there is no factual support for the contention that a vast majority of NetBank’s previously reported net income is a result of NetBank’s improper hedge accounting, and conclude that the court should dismiss such claims on these grounds.

Again, the court reminds Defendants of the burden on Plaintiffs to plead a factual basis for allegations during the Motion to Dismiss stage. When accepted as true, the various factual allegations in the Complaint suffice to state a claim under § 10(b) of the Exchange Act. The Complaint states that a confidential witness, who was a senior executive of the Company and had regular daily interactions with Defendants Freeman, Herbert, and Gross, indicated that a disagreement existed between NetBank and Ernst & Young regarding the calculation of the Company’s hedge effectiveness under FAS 133. (Am. Compl. ¶ 157.) Another allegation, supported by information from a confidential witness, states that “E&Y advised NetBank and its senior management that the Company’s hedge effectiveness testing under FAS 133 was not being conducted frequently enough to be reliable.” (Id. ¶ 158.) Likewise, yet another allegation details how NetBank received a comment letter from the SEC questioning its application of FAS 133 and the methods the Company used. (Id. ¶ 209.) In connection with such claim, the Complaint reads

“[t]he Individual Defendants knew that if the Company were required to apply a different method of assessing hedge effectiveness it would necessarily require a restatement of, at least, the Company's financial results as audited by E&Y for the years 2004 and 2005 and could spell financial ruin for NetBank.” (Id.) The court therefore finds Plaintiffs have satisfied their burden on this point and dismissal is not appropriate.

(5) Internal Controls Over Financial Reporting

Finally, Defendants argue that dismissal is appropriate because they disagree that a September 28, 2007 Office of Thrift Supervision statement and a September 29, 2007 Wall Street Journal article “adequately to allege any misrepresentation or omission concerning NetBank’s controls over financial reporting.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 24.) In effect, they argue that these writings do not support the claim because they do not relate to controls over NetBank’s operations. (Id. at 24-25.) However, paragraph 243 of the Complaint alleges that in a September 28, 2007 press release, the Office of Thrift Supervision explained that “NetBank sustained significant losses in 2006 primarily due to early payment defaults on loans sold, weak underwriting, poor documentation, a lack of proper controls, and failed business strategies.” (Am. Compl. ¶ 243.) Additionally, paragraph 267 alleges that “[o]n September 27, 2007, The Wall Street Journal

reported that the collapse of NetBank was the largest U.S. banking failure in 14 years, observing in sum that weak underwriting, a lack of internal controls and a late push into subprime mortgage lending was the simple recipe for failure.” (*Id.* ¶ 267.) Again, a Motion to Dismiss is not the proper vehicle for examining the truth of factual allegations in a Complaint. The court finds that the allegations, when taken as true, are sufficient to state a claim for securities fraud under § 10(b) of the Exchange Act and refuses to dismiss the claims on this basis.

B. Scierter

The second pleading requirement under § 10(b) of the Exchange Act requires that “a securities fraud plaintiff . . . plead scierter with particular facts that give rise to a strong inference that the defendant acted in a severely reckless manner.” *Garfield v. NDC Health Corp.*, 466 F.3d 1255, 1264 (11th Cir. 2006) (citation and internal quotations omitted). Severe recklessness is defined as “those highly unreasonable omissions or misrepresentations that involve . . . an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.” *Id.* (citation and internal quotations omitted). In determining whether the required state of mind is adequately alleged, “[i]t does not suffice that a reasonable factfinder plausibly could infer the requisite state of mind

from the allegations in the complaint.” Moore’s, § 9.03[6][a][ii]. “Rather . . . the court must engage in a comparative evaluation . . . [and] consider both inferences urged by the plaintiff and competing inferences rationally drawn from the alleged facts.” Id. In ruling on a Rule 12(b)(6) motion to dismiss an action governed by the PSLRA, the court must consider the complaint in its entirety. Id. The appropriate inquiry thus “is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.” Tellabs, 127 S. Ct. at 2509.

1. Sufficiency of the Scienter Allegations

Defendants make two main arguments regarding Plaintiffs’ failure to raise a strong inference of scienter. First, Defendants argue that Plaintiffs rely primarily on allegations by confidential witnesses to establish scienter, which Defendants claim “cannot survive the exacting scrutiny of scienter allegations required by Tellabs.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 26.) Defendants’ second argument is that “[n]othing else alleged in the Complaint raises a strong inference of scienter,” and the claims must therefore fail due to insufficient pleading of this element. (Id. at 30.) In conjunction with this argument, Defendants’ Brief addresses Plaintiffs’ purported failure to allege facts raising a strong inference of scienter for each of the following claims: (1) NetBank’s core banking business; (2) GAAP

violations including (a) misstatements of assets and liabilities, (b) FAS 133, and (c) internal controls over financial reporting; and (3) Ernst & Young's resignation. In essence Defendants argue that scienter must be established for each of these claims by facts distinctly alleged as to each particular claim. (See id. at 30-33.)

As previously stated, when analyzing scienter on a Motion to Dismiss, the court addresses sufficiency by considering the entirety of the complaint, not the individual allegations themselves. See Moore's, § 9.03[6][a][ii]. Importantly, the inquiry focuses on whether collectively, all of the facts alleged give rise to a strong inference of scienter – not whether particular allegations in isolation suffice under the standard. See Tellabs, 127 S. Ct. at 2509. In light of this admonition, the court will analyze the whole of Plaintiffs' Complaint for the required inference of scienter, whether it be from confidential witnesses⁵ or other sources.

In the securities fraud context, severe recklessness can be “established by allegations that the defendants had knowledge of facts or access to information contradicting their public statements.” In re Unicapital Corp. Sec. Litig., 149 F. Supp. 2d 1353, 1372 (S.D. Fla. 2001) (citation and internal quotations omitted); see

⁵“Not only may confidential witnesses satisfy the particularity requirements, they may also form the basis on which an inference of scienter may be alleged.” Grand Lodge of Pa. v. Peters, 550 F. Supp. 2d 1363, 1370 (M.D. Fla. 2008).

also In re JDN Realy Corp. Sec. Litig., 182 F. Supp. 2d 1230, 1242 (N.D. Ga. 2002) (Story, J.) (finding scienter pleading requirements had been met under PSLRA and Rule 9(b) where the complaint alleged that the defendant “knew, or was severely reckless in not knowing, that [SEC filings and financial statement] disclosures were incomplete and that he was making misrepresentations to [the company’s] shareholders and buyers and sellers in the securities market.”). In Unicapital, the court found that the PSLRA’s scienter pleading requirement was satisfied because Plaintiffs had alleged that the Defendants knew of, yet failed to disclose or account for, adverse movements in the company’s financial figures in their SEC filings and public statements. See Unicapital Corp., 149 F. Supp. 2d at 1372.

In this case, Plaintiffs have alleged that Defendants were notified by the SEC of accounting misstatements relating to NetBank’s material misapplication of GAAP and FAS 133, but purposely withheld that information from the public for nearly a year. (Am. Compl. ¶ 323.) Plaintiffs also allege that Defendants knew Ernst & Young’s resignation as independent auditor was directly related to NetBank’s GAAP violations and internal control failings, yet similarly failed to publicly disclose this information. (Id. ¶ 324.) Likewise, Plaintiffs allege the existence of scienter when Defendants intentionally and purposefully failed to file any financial reports with the SEC following the filing of NetBank’s Form 10-Q for the fiscal

quarter ended September 31, 2006. (Id. ¶ 325.) They argue that on account of this failure to file, NetBank did not meet its obligations to (1) report timely and accurate financial information and (2) correct and restate NetBank's prior financial statements as was necessary. (Id.) The court finds that based on these allegations from the Complaint, Plaintiffs have alleged facts sufficient to satisfy the PSLRA's scienter pleading requirement.⁶

2. Absence of Class Period Stock Sales

Defendants also argue that even if Plaintiffs have established scienter in the pleadings, their failure to allege any sales of NetBank stock during the Class Period by Defendants undercuts any inference of scienter. Defendants describe that Defendants Herbert and Gross collectively retained over 100,000 shares of NetBank

⁶Plaintiffs' Response brief contains a plethora of additional citations to the Complaint that it argues are sufficient to satisfy the scienter pleading requirement. These include statements by confidential witnesses that purport to establish the presence of Defendants' scienter (Mem. of Law in Opp'n to Defs.' Mot. to Dismiss 26-28) as well as other indicia of fraud including Defendants' own admissions that certain NetBank financial reports were materially misstated and could not be relied upon. (Id. at 28-30.) However because the court has already found the scienter pleading requirement to be satisfied, it will not further recite here each of these specific allegations in the Complaint. Likewise, because scienter has been established without the necessity of resorting to allegations made on the basis of information from confidential witnesses, it is unnecessary to address Defendants' arguments that such individuals' allegations deserve "little weight" for various assorted reasons. (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 27.)

stock through the end of the Class Period, and acquired shares through the end of March 2007. They conclude that because “Plaintiff offers no explanation for why the alleged principal perpetrators of a fraudulent scheme to inflate NetBank’s stock price would continue to acquire and retain shares,” dismissal is appropriate for a lack of scienter. (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 34.)

However, none of the cases cited by Defendants support their argument. The court in PR Diamonds, Inc. v. Chandler, 91 Fed. App’x 418, 436 (6th Cir. 2004) concluded its discussion of scienter by stating that “we have never held that the absence of insider trading defeats an inference of scienter. “ Likewise, while discussing motive as one factor relevant to scienter, the court in In re K-tel International, Inc. Securities Litigation, 300 F.3d 881, 894 (8th Cir. 2002) stated merely that “evidence that the individual defendants abstained from trading may undercut allegations of motive” – *not* that a lack of trading vitiates a prior finding of adequate scienter pleading. Finally, in deciding a motion for summary judgment, the court in In re Northern Telecom Ltd. Securities Litigation, 116 F. Supp. 2d 446, 462 (S.D.N.Y. 2000) noted simply that the absence of stock sales by insiders was “inconsistent with an intent to defraud shareholders.” Because Defendants provide no legal support for their assertion that the absence of Class Period stock sales

negates previously determined inferences of scienter, the court declines to dismiss Plaintiffs' claims on this basis.

C. Causation

Finally, Defendants argue that Plaintiffs' Complaint must be dismissed because it fails to adequately allege that the claimed investment losses were proximately caused by the alleged fraud. They assert that Plaintiffs mention only one instance in which NetBank stock lost value in response to a disclosure of news, and that this had nothing to do with revealing the "truth" of alleged prior misstatements or omissions. (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 35-36.) Instead, Defendants argue that the information released to the public related to "prior reports of declining performance" that were already known to investors (Id. at 36.) Defendants state that because Plaintiffs have failed to allege a causal connection between NetBank stock price drops and revelations of the "truth," their claims must be dismissed.

In a securities fraud case, Plaintiffs must adequately allege that their losses were proximately caused by the alleged fraudulent statements. "Loss causation' refers to the link between the defendant's misconduct and the plaintiff's economic loss." Rousseff v. E.F. Hutton Co., 843 F.2d 1326, 1329 n.2 (11th Cir. 1988). "Loss causation does not require a showing that the alleged misstatements were the sole

cause of loss; however, Plaintiffs must allege adequately that the material misstatements or omissions were a 'significant contributing cause' to the loss." In re Immucor Inc. Sec. Litig., No. 1:05-cv-2276-WSD, 2006 U.S. Dist. LEXIS 72335, at *56-57 (N.D. Ga. Oct. 4, 2006) (Duffey, J.) (citing Robbins v. Koger Props., 116 F.3d 1441, 1447 (11th Cir. 1997)). In essence this requires a plaintiff to allege that the share price of the security "fell significantly after the truth became known." Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 347 (2005). Overall, the complaint must contain "a short and plain statement of the claim' . . . [that] provide[s] the defendant with 'fair notice of what the plaintiff's claim is and the grounds upon which it rests.'" Id. at 346 (quoting Fed. R. Civ. P. 8 and Conley v. Gibson, 355 U.S. 41, 47 (1957)). The focus on the inquiry, thus, is whether "a plaintiff who has suffered an economic loss [has] provide[d] a defendant with some indication of the loss and the causal connection that the plaintiff has in mind." Id. at 347.

In their Complaint, Plaintiffs allege that on May 21, 2007, NetBank announced that "contrary to its prior public representations, its core banking business was in fact highly deficient and that the Company had failed to meet its regulatory capital requirements." (Am. Compl. ¶ 11.) This announcement also informed investors that

as a result of this significant deficiency in its core banking business, banking regulators were forcing the Company to consummate a sale

of its \$2.5 billion of core and brokered deposits, its held for investment loan portfolio, all of the assets and liabilities of NetBank Business Finance, the Company's small business equipment leasing and financing operation, and the NetBank brand and related trademarks and service marks.

(Id.) Plaintiffs claim that as part of this disclosure, NetBank announced the forced sale of certain portions of the Company, that were estimated to result in a loss of \$60-70 million. Plaintiffs also allege that “[t]hese disclosures were effectively admissions that the Company’s books and valuations were grossly overstated and misstated, and that . . . NetBank [had] failed to account properly for its mortgage business.” (Id.) They claim that as a result of such disclosures, NetBank’s common stock price decreased by 66%, from \$1.75/share on May 18, 2007 to \$0.59/share on May 21, 2007. Plaintiffs similarly allege that with the May 21, 2007 announcement, NetBank “had thus revealed that its efforts to enter new business segments by leveraging its core business was a failure and that the initial appearance that that strategy had been positive was premised upon the Company's false and misleading financial statements for the years 2004 and 2005 prepared by E&Y.” (Id. ¶ 217.)

Plaintiffs next allege the following:

Defendants made material misrepresentations and omissions regarding, among other things, the Company's financial reporting, financial condition, internal controls, business operations, corporate restructuring, core banking business, lending practices and exposure to subprime mortgages. When the truth concerning these issues was revealed to the investing public beginning on May 21, 2007, the price

of NetBank's securities materially declined as the remaining artificial inflation dissipated.

(Id. ¶ 326.) Finally, Plaintiffs also allege that beginning October 2006, the investing public learned of “adverse facts and circumstances attributable to the fraud alleged [in the Complaint],” and that “as a result, the price of NetBank stock suffered numerous declines.” (Id. ¶ 333.) This information included “the ‘resignation,’ or firing of NetBank CEO Freeman, the resignation of NetBank's auditor E&Y, reports of dismal financial results, reported delays in reporting financial data and filing requisite reports with the SEC, and the Company's failure to file requisite financial reports with the SEC.” (Id.) The court finds that Plaintiffs have sufficiently alleged that the share price of NetBank’s common stock fell significantly after the truth as to the Company’s financial well-being became known to the investing public. In pleading causation, Plaintiffs have done more than provide Defendants with notice regarding the loss as well as the “causal connection” that they have “in mind.” Dura Pharms., 544 U.S. at 347. In light of the notion that “proof of loss causation should not typically be resolved on a Rule 12(b)(6) motion, as here the Plaintiffs have adequately alleged that their financial loss is connected to the Defendants' fraudulent conduct,” the court finds that dismissal based on a lack of sufficient proximate causation pleading is not appropriate. In re PSS World Med., Inc. Sec. Litig., 250 F. Supp. 2d 1335, 1351 (M.D. Fla. 2002).

D. Group Pleading Doctrine

Defendants next argue that each of the individual Defendants named in this case are not liable under § 10(b) of the Exchange Act for statements that they as individuals did not make. Defendants thus identify particular statements that each of the individual Defendants is alleged to have said, and argue that for each Defendant, he or she may only be liable at most for these individual statements. In an effort to further limit their individual liability, Defendants argue that “[t]o the extent that Plaintiff seeks to rely on the so-called ‘group pleading doctrine’ to recover against any Defendant for statements not specifically attributed to him, such reliance is improper.” (Mem. of Law in Supp. of Defs.’ Mot. to Dismiss 39.)

“The group pleading doctrine in securities litigation . . . can be broadly characterized as a presumption of group responsibility for statements and omissions in order to satisfy the particularity requirements for pleading fraud under Federal Rule of Civil Procedure 9(b).” Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015, 1018 (11th Cir. 2004). The doctrine has been used “to impute the actions or knowledge of some defendants to other defendants, or to presume action or knowledge solely from a defendant's title or position.” Id. at 1019. Likewise, under the doctrine,

[i]n cases of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports,

press releases, or other 'group-published information,' it is reasonable to presume that these are the collective actions of the officers. Under such circumstances, a plaintiff fulfills the particularity requirement of Rule 9(b) by pleading the misrepresentations with particularity and where possible the roles of the individual defendants in the misrepresentations.

Id. (citation and internal quotations omitted). However, the doctrine "varies somewhat among the circuits," and the Eleventh Circuit has not specifically ruled on its viability after the enactment of the PSLRA. Id. at 1018. Despite the Phillips decision, district courts within the circuit have continued to apply the group pleading doctrine to plaintiffs' claims in securities fraud cases. See e.g., In re Immucor, 2006 U.S. Dist. LEXIS 72335, at *24 n.5 ("The Court finds that the [group pleading] doctrine necessarily applies and Plaintiffs have pleaded claims against the Individual Defendants"); In re JDN, 182 F. Supp. 2d at 1251 (finding that Plaintiffs had stated a claim against the Defendants under the doctrine, and stating: "Particularly at the motion to dismiss stage of litigation, before Plaintiffs have opportunity to conduct discovery, the group pleading doctrine is appropriate and fair."); but see In re Premiere Techs. Inc. Sec. Litig., No. 1:98-CV-1804-JOF, 2000 WL 33231639, at *10 (N.D. Ga. Dec. 8, 2000) (Forrester, J.) (holding that the PSLRA abolished the group pleading doctrine). At least in the current posture of this case, the court will not dismiss those claims which may rely on the group pleading doctrine.

The substance of Plaintiffs' Complaint makes clear that the individual Defendants were all board members and/or officers of NetBank. (See Am. Compl. ¶¶ 30-43.) The Complaint is also replete with allegations that Defendants committed fraud in issuing press releases, annual reports, and other group-published information. Because of this, together with the fact that, at this early stage of the proceedings, the parties have not analyzed specifically which claims against which Defendants would be affected if group pleading were not allowed, the court finds that Plaintiffs adequately state a claim against the Defendants for securities fraud.⁷

E. § 20(a) Claim

Finally, Defendants argue that Plaintiffs' Complaint fails to state a viable claim under § 20(a) of the Exchange Act. In order to allege a violation of § 20(a), a plaintiff must allege: (1) a primary violation of securities laws by the corporation; (2) authority on the part of individual defendants to control general business affairs of corporation; and (3) requisite power on the part of individual defendants to directly or indirectly control or influence specific corporate policy that resulted in

⁷To the extent that the individual Defendants explicitly signed the various statements at issue, the group pleading doctrine may be unnecessary, as other circuits have recognized in like circumstances that "signers of documents should be held responsible for the statements in the document." Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061 (9th Cir. 2000).

primary liability. Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1237 (11th Cir. 2008). Defendants argue that Plaintiffs fail to state such a claim because (1) they have not asserted any securities claims against the allegedly controlled person, NetBank; (2) the Complaint does not adequately allege that NetBank or any Defendant committed any primary violation of the securities laws; and (3) Plaintiffs have not adequately alleged Defendants' purported control over NetBank. (Mem. of Law in Supp. of Defs.' Mot. to Dismiss 40.)

First, the court finds that Plaintiffs' Complaint satisfies the first requirement of alleging "a primary violation of the securities laws" by the corporation. Mizzaro, 544 F.3d at 1237. Plaintiffs expressly state that "NetBank violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder." (Am. Compl. ¶ 28; see also ¶¶ 22-27.) This is distinct from what the Defendants advocate as being required pleading—that the Plaintiffs assert a securities claim *against* the corporation itself.⁸ In analyzing the first requirement for a § 20(a) claim, courts adhere to the principle that "there is no requirement in the language of [Section 20(a)] that the controlled person be named as a defendant as a predicate to imposing liability upon the controlling individual defendants. A plaintiff need only establish

⁸The court cannot find, and Defendants do not provide, any support for requiring that a claim of a § 20(a) violation be pled that way.

the controlled person's liability." In re Suprema Specialites, Inc. Sec. Litig., 438 F.3d 256, 285 (3d Cir. 2006). Therefore this court finds that Plaintiffs have sufficiently alleged a claim under the first requirement of § 20(a) of the Exchange Act.

Defendants' second argument is that Plaintiffs have failed to adequately allege that NetBank or any Defendant committed any primary violation of the securities laws. As discussed above, the Complaint makes multiple allegations that NetBank committed a violation of the securities laws. Likewise, the Complaint explains that this case is "a federal securities law class action brought against NetBank's senior officers and directors," then lists each of the individual Defendants. (Am. Compl. ¶ 1.) It goes on to allege that "[d]uring the Class Period, Defendants engaged in a fraudulent scheme to artificially inflate the price of NetBank's publicly-traded common stock, in violation of the federal securities laws, §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 . . . and Rule 10b-5 promulgated thereunder." (Id. ¶ 2.) Finally, Plaintiffs allege that "Defendants defrauded Class members by making materially false and misleading statements and omissions regarding the financial results, operations and condition of the Company." (Id. ¶ 3.) The court finds that Plaintiffs have adequately alleged that NetBank and the individual Defendants committed primary violations of the securities laws.

Defendants' third and final argument on this point is that Plaintiffs have not adequately alleged Defendants' purported control over NetBank. The court finds that Plaintiffs have satisfied this pleading requirement as well. The Complaint contains allegations that Defendant Freeman possessed the power and authority to control both the Board and officers and other executives of NetBank. (Id. ¶ 34.) Likewise, Plaintiffs claim that he had the power to direct the acts and transactions of the Company. Additionally, the Complaint alleges that as Chief Financial Executive of NetBank, Defendant Gross "possessed the power to, and did in fact, control and direct the acts and transactions of NetBank and the acts of NetBank's officers as they related to the Company's application of accounting methods and financial reporting of the operations of NetBank." (Id. ¶ 36.) Lastly, Plaintiffs allege that "[b]ecause of their positions with the Company, all of the Individual Defendants controlled and/or possessed the power and authority to control the contents of the Company's SEC filings, press releases, and presentations to securities analysts, through which information was conveyed to the analysts and then to the investing public." (Id. ¶ 47.) Because Plaintiffs have satisfied this third pleading requirement as well, dismissal for failure to state a claim for a violation of § 20(a) of

the Exchange Act is not appropriate.⁹

IV. Summary

For the foregoing reasons, Defendants' Motion to Dismiss the Consolidated and Amended Class Action Complaint [Doc. No. 40] is DENIED.

In keeping with the Scheduling Order entered on May 19, 2008, Defendants will have 30 days from the date of this Order to file their Answer. However, the court AMENDS the Scheduling Order to provide that the 8-month discovery period in this case will begin effective on the date of this Order. This case was filed on September 19, 2007, and the court is aware of no reason why there should be further delay in beginning discovery. Discovery will end on September 28, 2009. Also, the parties are advised that the court will not grant any extensions of the 30 day deadline for Defendants to file their Answer.

IT IS SO ORDERED, this 29th day of January, 2009.

s/Beverly B. Martin
BEVERLY B. MARTIN
UNITED STATES DISTRICT JUDGE

⁹The court does not understand Defendants to argue that Plaintiffs have not satisfied the second prong, requiring that the Complaint allege authority on the part of individual defendants to control general business affairs of corporation. See Mizzaro, 544 F.3d at 1237. However if they did, the court finds Plaintiffs' Complaint adequately alleges such authority on the part of each Defendant. (Am. Compl. ¶¶ 30-43.)

