

[Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—S.D. Cal.: Claims against Bofl, ‘far from frivolous,’ offered a second chance, \(Jun. 20, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

A class of Bofl shareholders failed to state a claim that the bank and its officers and directors violated the securities laws by misrepresenting whether federal regulators were investigating Bofl in connection with improper activity and whether the bank engaged in lending to criminals. The Southern District of California granted leave to amend the complaint to cure the deficiencies it found, chiefly regarding falsity and loss causation ([Mandalevy v. Bofl Holding, Inc.](#), June 19, 2018, Curiel, G.).

Questionable loan practices. A 2015 *New York Times* article suggested that Bofl was lending to individuals who were later convicted or accused of fraud and those who had defaulted on large loans to other banks. According to the article, Bofl's practice of making loans to "foreigners" invited anti-money-laundering scrutiny from regulators. The article was followed by a whistleblower protection suit by a former Bofl auditor who alleged that Bofl loaned money to "criminals and politically exposed persons," potentially in violation of the Bank Secrecy Act's AML rules.

The complaint also referred to a confidential witness who worked as a Bofl underwriter and two 2016 articles in *Seeking Alpha*, one asserting that Bofl took steps to conceal details regarding another whistleblower and the other suggesting that Bofl made loans to a special purpose entity for the benefit of "a convicted fraudster." Bofl stock fell 14.53 percent after the second article was published.

Regulatory investigations. The SEC opened an informal inquiry in 2015, then a formal investigation the following year during the course of which it subpoenaed Bofl. The regulator was inquiring into related-party transactions, potential conflicts of interest, and loans made to a nonresident alien. Bofl did not disclose the existence of the subpoenas. The *New York Post* reported that the DOJ and Treasury were also investigating Bofl along with the SEC. The SEC ultimately determined not to recommend enforcement action against the bank.

Falsity. The complaint alleges that the defendants made misrepresentations and omissions in SEC filings, press releases, and conference calls that failed to disclose the ongoing regulatory investigations; the existence of a second whistleblower; that a material portion of earnings derived from "loans made directly or indirectly to criminals;" and that the investigations amounted to a breach of the bank's code of ethics.

The court saw nothing in the complaint to suggest that statements in the SEC filings were misleading. One of the statements asserted that the audit committee engaged Dentons to investigate the first whistleblower's accusations and concluded them to be without merit, but there were no allegations in the complaint suggesting that Dentons did not investigate or reach that conclusion. And while statements in the Forms 10-Q setting forth Bofl's quarterly financial and operating results were objectively verifiable, the complaint did not explain how these statements were misleading or how the contents of these filings gave the impression that the bank was not lending to "criminals."

The court next turned to the statements made in conference calls and press releases, which it separated into statements that were non-actionable and those that might meet the heightened pleading standard. One of the assertions that the plaintiffs relied upon the most heavily was a conference call statement that there had been no regulatory event that would require disclosure and that the bank had not received any inquiry from any agency that would suggest concerns requiring Bofl to file a Form 8-K. The plaintiffs offered no reason that it was false

or misleading to make this statement, and the court distinguished the cases they cited finding that a failure to disclose regulatory investigations was a material misrepresentation.

Loss causation. Some statements, however, were potentially actionable: a statement that the whistleblower's allegations were "disconnected from reality," that Bofl had not made any loans to a specific related party, and a statement that there were no investigations regarding potential money laundering. Here, the complaint failed for insufficient allegations of loss causation.

The statement pertaining to the whistleblower was allegedly corrected by the *Seeking Alpha* article discussing loans made to the special purpose entity. However, the court agreed with the defendants that the article could not serve as a corrective disclosure because it relied on public information. The plaintiffs did not persuade the court that the market would not have been able to identify the connection between Bofl and the indirect loan recipient based on the same public filings that the *Seeking Alpha* writer used.

Furthermore, there was no alleged corrective disclosure of Bofl's denial of the related-party loans other than a *Seeking Alpha* article that predated the statement. Finally, the court examined a press release that disclaimed a 2017 *New York Post* article's statement that federal agents were looking into possible money laundering. A subsequent *Post* article could not serve as the corrective disclosure to this statement because it did not disclose any previously nonpublic information. Because the plaintiffs rely on the fraud-on-the-market theory, the court had to assume that all available information, including information available through a FOIA request, had already been incorporated into the market price for the stock by the time the article was published. "The fact that a market participant would have had to jump through a bureaucratic hoop to obtain this information does not mean that the information was not 'public,'" the court reasoned.

Rather than sanctioning plaintiffs, court grants leave to amend. The defendants asked the court to sanction the plaintiffs for filing a "copy-cat" suit based on a [case](#) that was recently dismissed. The court declined because the new complaint is based on different facts and brings claims that "are far from frivolous." Because amendment could cure the complaint's deficiencies, the court allowed the plaintiffs 21 days to file an amended complaint.

The case is [No. 17-cv-00667](#).

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Companies: Bofl Holding, Inc.

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