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IN THE STATE COURT OF FULTON COUNTY  
STATE OF GEORGIA

ALVIN COHEN, ELAINE REICH,	)	
KAYUM A. SHAIKH and SHARI A.	)	
SHAIKH on behalf of themselves and	)	
all others similarly situated,	)	
	)	CIVIL ACTION NO.
Plaintiffs,	)	96VS-114982D
v.	)	
	)	
VALUJET AIRLINES, INC.,	)	
VALUJET, INC., SABRETECH, INC.,	)	
MICHAEL D. ACKS, TIMOTHY FLYNN	)	
ROBERT L. PRIDDY, LEWIS A.	)	
JORDAN, MAURICE J. GALLAGHER,	)	
JR., and STEPHEN C. NEVIN,	)	
	)	
Defendants.	)	
_____	)	

**DEFENDANTS' MOTION TO DISMISS  
FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED**

Pursuant to O.C.G.A. § 9-11-12, Defendants ValuJet Airlines, Inc., ValuJet, Inc., Michael D. Acks, Timothy Flynn, Robert L. Priddy, Lewis Jordan, Maurice J. Gallagher, Jr., and Stephen C. Nevin respectfully request this Honorable Court to dismiss this action with prejudice on the ground that Plaintiffs have failed to state a claim upon which relief can be granted. Highly summarized, the bases for this motion are:

**(1) Plaintiffs have failed to satisfy the reliance element of their common law claims for fraud and negligent misrepresentation.** Plaintiffs' claims of common law fraud and negligent misrepresentation each require Plaintiffs to plead and prove the element of actual reliance. Plaintiffs attempt to satisfy this element of reliance by borrowing the federal securities law pleading concept of fraud-on-the-market, rather than through pleading actual reliance. Accordingly, Plaintiffs have

failed to state an essential element of each of these claims, which

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claims should both be dismissed with prejudice.

**(2) Plaintiffs, as shareholders, are not in the class of individuals who may recover for negligent misrepresentations contained in public statements such as press reports and securities filings.** Courts uniformly hold that a shareholder has no remedy for mere negligent misrepresentation contained in public statements, as opposed to intentional fraud. Plaintiffs' Complaint relies exclusively on such public statements and the negligent misrepresentation claim should be dismissed with prejudice.

**(3) Plaintiffs have pled no intrastate transaction governed by the Georgia Securities Act.** The Georgia Securities Act only governs transactions in Georgia, as opposed to transactions that cross state lines or take place outside of Georgia. Nonetheless, Plaintiffs' Complaint identifies no such transactions and therefore fails to state a claim under the Georgia Securities Act and should be dismissed with prejudice.

**(4) Plaintiffs have pled neither privity nor reliance under the Georgia Securities Act.** State Blue Sky Laws, such as the Georgia Securities Act, require some form of transactional nexus to the misrepresentations at issue. Some state courts require actual privity while others require actual reliance. Plaintiffs have pled neither actual privity nor actual reliance, but instead rely on the federal securities law concept of fraud-on-the-market, which does not satisfy the elements of a claim under the Georgia Securities Act.

Furthermore, as to the three claims alleged, Plaintiffs' Complaint fails to plead some elements of these claims completely, contains allegations legally inadequate to state other elements, or fails to plead certain elements with the required level of particularity. Defendants also incorporate by reference the defenses asserted in their Answer of this date, including

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insufficiency of process.

This motion is supported by an accompanying brief.

Dated: December 23rd, 1996  
Atlanta, Georgia

Respectfully submitted,

/s/

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J. Allen Maines  
Ga. Bar No. 466575  
Eric C. Lang  
Ga. Bar No. 435515  
Sharon M. Glenn  
Ga. Bar No. 297305

LONG, ALDRIDGE & NORMAN  
303 Peachtree Street  
Suite 5300  
Atlanta, GA 30308  
404-527-4000

Attorneys for Defendants:

ValuJet Airlines, Inc., ValuJet, Inc.,  
Michael D. Acks, Timothy Flynn,  
Robert L. Priddy, Lewis Jordan,  
Maurice J. Gallagher, Jr., and  
Stephen C. Nevin

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ROBERT L. PRIDDY, LEWIS A.	)	
JORDAN, MAURICE J. GALLAGHER,	)	
JR., and STEPHEN C. NEVIN,	)	
	)	
Defendants.	)	
_____	)	

**BRIEF IN SUPPORT OF  
DEFENDANTS' MOTION TO DISMISS  
FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED**

Submitted by:

J. Allen Maines  
Ga. Bar No. 466575  
Eric C. Lang  
Ga. Bar No. 435515  
Sharon M. Glenn  
Ga. Bar No. 297305  
LONG, ALDRIDGE & NORMAN  
303 Peachtree Street  
Suite 5300  
Atlanta, GA 30308  
404-527-4000

Attorneys for Defendants:  
ValuJet Airlines, Inc., ValuJet, Inc.,  
Michael D. Acks, Timothy Flynn,  
Robert L. Priddy, Lewis Jordan,  
Maurice J. Gallagher, Jr., and  
Stephen C. Nevin

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I. **PRELIMINARY STATEMENT.**

Plaintiffs, to avoid facing higher standards under the Federal Private Securities Litigation Reform Act of 1995 (the "Reform Act"), have filed what is, in essence, a claim under federal securities laws, but have attempted to make their federal allegations fit the framework of inapplicable state common law and statutory causes of action. Indeed, Plaintiffs describe the Defendants as having violated "federal securities laws." (Complaint ¶¶ 14, 67.) Such a run to the state courts by plaintiffs was predicted in the wake of the Reform Act by various commentators.<sup>1</sup>

Plaintiffs' effort in the instant case fails to state a claim upon which relief can be granted because the Plaintiffs fail to recognize dispositive distinctions between state and federal law which require dismissal of this action as follows:

- **Failure to plead actual reliance in common law claims.** Plaintiffs' common law claims for fraud and negligent misrepresentation each require Plaintiffs to plead and prove actual reliance. Plaintiffs, however, do not plead actual reliance. Instead, Plaintiffs plead indirect reliance based on the fraud-on-the-market presumption, which presumption is recognized only under *federal* securities law. This presumption is unavailable to support common law causes of action. Because Plaintiffs have not pled this essential element of these two claims, these claims should be dismissed with prejudice.
- **Failure to plead membership in the limited class of individuals entitled to protection from common law negligent misrepresentation.** A claim of negligent misrepresentation is available only to a limited class of individuals, which class has repeatedly been held not to extend to shareholders whose only exposure to the alleged misrepresentations is through statements in the press or statements in securities filings. The Complaint,

however, only identifies such unactionable statements and accordingly Plaintiffs' claim for negligent misrepresentation should be dismissed with prejudice.

- **Failure to plead the existence of transactions in**

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<sup>1</sup>See e.g., Kahn and Metcalfe, "After Federal Securities Reform: Blue Sky Ahead for Colorado Class Actions--Part II," *Colorado Lawyer*, August, 1996 at 45 ("filing suit in state court becomes more attractive as a forum option . . ."); France, "Bye Fraud Suits. Hello, Fraud Suits," *Business Week*, June 24, 1996, 1996 WL 10769217, (mentioning this action, noting "And to sidestep the statute, plaintiffs' attorneys have sued dozens more companies in state courts").

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**Georgia governed by the Georgia Securities Act.**

The Georgia Securities Act reaches only transactions that occur within the state of Georgia. Plaintiffs have not pled any such transactions. Quite to the contrary, Plaintiffs speak of "interstate" and "national" transactions. (Complaint ¶¶ 7, 11, 21.) Because Plaintiffs have pled no Georgia transactions, their claim under the Georgia Securities Act should be dismissed with prejudice.

- **Failure to plead either privity or actual reliance under the Georgia Securities Act.** Unlike federal securities laws, which reach national market-wide fraud, state Blue Sky Laws such as the Georgia Securities Act are concerned with direct relationships and transactions between buyer and seller. This requirement of a direct relationship has been implemented by various courts by either requiring privity between plaintiff and a defendant, or by requiring showing of actual reliance. Plaintiffs, who rely solely on the fraud-on-the-market doctrine, have pled neither privity nor actual reliance, therefore their claims under the Georgia Securities Act should be dismissed with prejudice.

Simply put, Plaintiffs have attempted to plead a state case merely by entitling their federal claims as state law causes of action, without regard to key differences between state and federal law. Furthermore, even assuming the existence of valid state law causes of action, Plaintiffs have not plead the elements of those causes of action.

**II. STATEMENT OF FACTS.**

The facts relevant to this motion, taken as pleaded in Plaintiffs' Complaint, are as follows.

ValuJet is a commercial airline operated by Defendant ValuJet Airlines, Inc., a wholly owned subsidiary of Defendant ValuJet, Inc. (Complaint ¶ 11.) On May 11, 1996, a ValuJet flight crashed in the Florida Everglades, with everyone aboard the plane dying. (Complaint ¶ 55.) On May 13, 1996, the first trading day after the crash, the publicly traded stock of ValuJet, Inc. dropped approximately 23% in value (Complaint ¶ 56.) Soon thereafter, the Complaint in this action, as well as numerous other complaints,<sup>2</sup> was filed against the Defendants to this action, who are ValuJet

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<sup>2</sup>One other action was filed in this court. *R. Neil Hepler IRA., et al. v. ValuJet Airlines, Inc., et al.*, State Court of Fulton County; Case No. 96VS-0114982D. Eleven actions were filed in the United States District Court for the Northern District of Georgia,

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Inc., ValuJet Airlines, Inc. and numerous individuals alleged to be officers and directors of those companies.<sup>3</sup> Each action seeks recovery against the Defendants for the drop in the stock price of ValuJet, Inc. which occurred after the unfortunate crash.

The Complaint in this action accuses Defendants of committing the common law torts of fraud and negligent misrepresentation. The Complaint also accuses Defendants of violations of the Georgia Securities Act, O.C.G.A. § 10-5-1 *et seq.* (the "Georgia Securities Act").

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which actions have been consolidated. *Matin G. Agius v. ValuJet Airlines, Inc., et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1856-

JTC; *Boryk et al. v. Robert L. Priddy et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1767; *Courteau, et al. v. ValuJet Airlines, Inc., et al.*, U.S.D.C., N.D. GA; Case NO. 1:96-CV-1705; *Eaztov Holdings et al. v. ValuJet Airlines, Inc., et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1894-JTC; *Glore, et al. v. ValuJet Airlines, Inc., et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1855-JTC; *John Kenney v. ValuJet Airlines, Inc., et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1889-JTC; *Dennis Lynch et al. v. ValuJet Airlines, Inc. et al.*, U.S.D.C. N.D. GA; Case No. 1:96-CV-1400-JTC; *Malekabadi et al. v. ValuJet Airlines, Inc. et al.*, U.S.D.C. N.D. GA; Case No. 1:96-CV-1355-JTC (now captioned *In re: ValuJet, Inc. Securities Litigation*); *Jack Marks v. ValuJet, Inc., et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1731-JTC; *Shubert, et al. v. ValuJet Airlines, Inc. et al.*, U.S.D.C. N.D. GA, Case No. 1:96-CV-1551-JTC. *Singer v. ValuJet Airlines, Inc., et al.*, U.S.D.C., N.D. GA; Case No. 1:96-CV-1704. One additional action has been filed in the Northern District of Georgia but not yet served. Finally, one action was filed in the Middle District of Florida and transferred to the Northern District of Georgia and is to be consolidated with the others. *Moore, et al. v. ValuJet Airlines, Inc., et al.*, U.S.D.C. M.D. FLA, Tampa Division, Case No. 96-1298-CIV-T23B.

<sup>3</sup>The discrete roles of many Defendants are obscured by allegations lumping them together collectively. In 1992, ValuJet Airlines, Inc. was incorporated. It was not until October, 1995 that the distinction between ValuJet, Inc. and ValuJet Airlines, Inc. came into existence, when shares in ValuJet Airlines, Inc. were converted one-for-one into shares of ValuJet, Inc. (Complaint, ¶ 11.) Defendant Acks is not an executive officer or director of either ValuJet, Inc. or ValuJet Airlines, Inc. Defendant Nevin has never been a director of either ValuJet, Inc. or ValuJet Airlines, Inc.; he has served as senior vice president and chief financial officer of ValuJet, Inc. and ValuJet Airlines, Inc. since May, 1994. Defendants Chapman and Flynn have served only as directors of ValuJet Airlines, Inc. since April, 1994 and July, 1992 respectively. Until October 1996, Defendant Gallagher served as a director and officer of both. Defendant Jordan has served as a director of ValuJet Airlines, Inc. and ValuJet, Inc. and both as a director and officer of ValuJet Airlines, Inc.. Defendant Priddy has served as chairman of both ValuJet, Inc. and ValuJet Airlines, Inc.

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Although each of the causes of action alleged by the Plaintiffs in this action contain common elements of misrepresentation and reliance, the Complaint lacks a number of allegations. There is no allegation that any Plaintiff dealt directly with any Defendant. There is no allegation that the

alleged misrepresentations contained in the Complaint formed the basis for investment in ValuJet, Inc. by any Plaintiff. Similarly, although the Complaint seeks recovery in a Georgia court for violations of Georgia law, there is no allegation in the Complaint that the transactions complained of either by an individual Plaintiff or by the class that the Plaintiffs seek to represent occurred in Georgia. To the contrary, Plaintiffs plead that these transactions occurred across the United States.

### III. ARGUMENT AND CITATION OF AUTHORITY.

It is proper to dismiss a claim, with prejudice, when the Plaintiff "would not be able to recover under any state of provable facts." *Mr B.'s Oil Co., Inc. v. Register*, 181 Ga. App. 166, 168, 351 S.E.2d 533, 535 (1986) (reversing denial of motion to dismiss when claim asserted by plaintiff was not recognized by law); *Continental Investment Corp. v. Cherry*, 124 Ga. App. 863, 866, 186 S.E.2d 301, 303 (1971) (affirming Fulton Superior Court's (Judge J. Etheridge) grant of motion to dismiss fraud complaint where "the complaint disclose[d] with certainty that plaintiff would not be entitled to relief under any state of facts that could be proved in support of the claim" (citations omitted)). In this action, dismissal with prejudice is appropriate because the legal theories underlying the Complaint are not recognized under Georgia law.

**A. Plaintiffs' Causes of Action for Fraud and Negligent Misrepresentation Should Be Dismissed Because Plaintiffs Have Not Pled the Required Element of Actual Reliance.**

Plaintiffs' causes of action for common law fraud, (Complaint,

(Complaint, "Fourth Claim," ¶¶ 89 - 93), each require Plaintiffs to plead and prove the element of reliance. See *Marriott Corp. v. American Academy of Psychotherapists, Inc.*, 157 Ga. App. 497, 499, 277 S.E.2d 785, 787 (1981) (stating that "justifiable reliance by the plaintiff" is one of the elements of fraud in Georgia); *Bates & Assocs., Inc. v. Romei*, 207 Ga. App. 81, 85, 426 S.E.2d 919, 923 (1993) (noting that negligent misrepresentation claims require proof of "reasonable reliance on the false information").

Plaintiffs attempt to meet this required element through the fraud-on-the-market presumption. (Complaint, "Applicability of Presumption of Reliance: Fraud-on-the-Market Doctrine" ¶¶ 26 - 27.) The fraud-on-the-market presumption was explained in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), as follows:

"The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.... Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.... The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations." *Peil v. Speiser*, 806 F.2d 1154, 1160-1161 (CA3 1986).

485 U.S. 241-42.

The Court endorsed the adoption of the fraud-on-the-market theory to create a rebuttable presumption of reliance upon a showing of the following elements:

A plaintiff must allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed. . . .elements (2) and (4) may collapse into

one.

485 U.S. 248, n. 27. Absent from these elements is any reliance by a plaintiff on the misrepresentations. Accordingly, a plaintiff who attempts to plead a fraud-on-the-market case is choosing not to plead actual reliance, but rather is attempting to set up a presumption of reliance. Plaintiffs in this action, by pleading fraud-on-the-market, make no attempt to plead with particularity their own individual and actual reliance on the statements contained in the Complaint.

The fraud-on-the-market presumption of reliance, however, does not satisfy the element of reliance for either fraud or negligent misrepresentation. *See Wells v. HBO & Co.*, 813 F. Supp. 1561 (N.D. Ga. 1992) (rejecting plaintiff's attempt to use fraud-on-the-market theory to establish presumption of reliance in negligent misrepresentation and fraud claims); *Mirkin v. Wasserman*, 858 P.2d 568 (Cal. 1993) (refusing to recognize fraud-on-the-market presumption of reliance with regard to fraud claim in California); *In re Herley Securities Litigation*, 161 F.R.D. 288 (E.D. Pa. 1995) (refusing to recognize fraud-on-the-market presumption of reliance with regard to negligent misrepresentation claim in Pennsylvania); *Deutschman v. Beneficial Corp.*, 132 F.R.D. 359 (D. Del. 1990) (noting that fraud-on-the-market presumption of reliance is not recognized in connection with negligent misrepresentation claim in Delaware); *In re Information Resources, Inc. Securities Litigation*, 1994 WL 124890 (N.D. Ill., April 11, 1994) (noting that Illinois does not recognize fraud-on-the-market presumption of

reliance for common law fraud claim); *In re SciMed Securities Litigation*, 1993 WL 616692 (D. Minn., Sept. 29, 1993) (fraud-on-the-market presumption of reliance not recognized under Minnesota law with regard to fraud and negligent misrepresentation claims); *Persky v. Turley*, 1991 WL 327434 (D. Ariz., Dec. 19, 1991) (same with regard to Arizona law); *In re Cascade International Securities Litigation*, 840 F. Supp. 1558 (S.D. Fla. 1993) (same with regard to Florida law). Thus, negligent misrepresentation and fraud

claims which assert fraud-on-the-market to prove actual reliance are subject to dismissal as a matter of law in Georgia. *See Wells*, 813 F. Supp. 1561 (dismissing negligent misrepresentation and fraud claims for failure to allege actual reliance).

Accordingly, because Plaintiffs have failed to plead a required element of the causes of action for fraud and negligent misrepresentation, this Court should dismiss each of those causes of action.

**B. Plaintiffs Claim for Negligent Misrepresentation Should Be Dismissed Because Plaintiffs Have Not Pled Membership in the Limited Group of Individuals Entitles to Bring a Claim for Negligent Misrepresentation.**

Plaintiffs cannot prevail as a matter of law on their negligent misrepresentation claim because the law of negligent misrepresentation does not protect shareholders from negligently made misrepresentations contained in publicly-released documents such as securities filings or press reports. Because each misrepresentation contained in the Complaint is contained in such publicly-released documents, Plaintiffs have failed to state a

claim for negligent misrepresentation.

Georgia courts have adopted Restatement (Second) of Torts § 552 with regard to claims for negligent misrepresentation. *See Robert & Co. Assocs. v. Rhodes-Haverty Partnership*, 250 Ga. 680, 300 S.E.2d 503 (Ga. 1983) (adopting cause of action for negligent misrepresentation as set forth in Restatement (Second) of Torts § 552). Restatement (Second) of Torts § 552 limits the class of potential plaintiffs in a negligent misrepresentation action to "the person or one of a limited group of persons for whose benefit and guidance" the allegedly false information is provided. *See* Restatement (Second) of Torts § 552(2); *Brug v. The Enstar Group, Inc.*, 755 F. Supp. 1247, 1258 (D. Del. 1991) ("Under [Restatement (Second) of Torts § 552], such a defendant is liable only to 'a limited group of persons for whose benefit and guidance' the

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information is intended.").

Sound policy reasons support the general consensus to not extend duties under the tort of negligent misrepresentation to mere shareholders when the alleged misrepresentation is a public statement. The drafters of the Restatement explained as follows:

When the harm that is caused is only pecuniary loss, the courts have found it necessary to adopt a more restricted rule of liability, because of the extent to which misinformation may be, and may be expected to be, circulated, and the magnitude of the losses which may follow from reliance upon it.

Restatement (Second) of Torts § 552, cmt. a. Thus, the cause of action for negligent misrepresentation is narrowed "to ensure that liability for negligence is less extensive than that for conscious fraud." *Brug*, 755 F. Supp. at 1258; *see also* Restatement (Second)

of Torts § 552, cmt. a ("When there is no intent to deceive but only good faith coupled with negligence, the fault of the maker of the misrepresentation is sufficiently less to justify a narrower responsibility for its consequences.").

Investors whose losses are based on documents released to the public at large are not within the "limited group" of people entitled to bring suit for negligent misrepresentation. *See In re Westinghouse Securities Litigation*, 832 F. Supp. 948, 988 (W.D. Pa. 1993), *affirmed*, 90 F.3d 696 (3rd Cir. 1996) ("Where a corporation does not and cannot know the identity of the recipients of its disclosures at the time those disclosures are made, liability under Section 552(2) does not obtain."). Negligent misrepresentation claims based solely on such public documents, including SEC filings and press releases, are subject to dismissal as a matter of law. *See Brug*, 755 F. Supp. at 1258 (dismissing investors' negligent misrepresentation claim for lack of standing where action was based on a Form 8-K and company press releases); *In re Delmarva*

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*Securities Litigation*, 794 F. Supp. 1293 (D. Del. 1992) (dismissing investors' negligent misrepresentation claim for lack of standing where action was based on documents released to the public at large, such as the Annual Report and other SEC filings); *In re Mi-Lee Acquisition Fund II, L.P. Litigation*, 848 F. Supp. 527 (D. Del. 1994) (dismissing investors' negligent misrepresentation claim for lack of standing where action was based on statements contained in the defendants' Prospectus and Registration Statement). To permit any member of the public who might invest in a company's stock to

qualify as a permissible plaintiff would nullify the "limited group" requirement. *See Brug*, 755 F. Supp. at 1258 ("If any member of the public who might choose to invest in KCI common stock were to qualify as part of a protected class, then the 'limited group' requirement would be meaningless.").

A review of the allegations of Plaintiffs' Complaint reveals that every alleged misrepresentation is contained in a document released to the public at large by falling into one of two categories: (a) news reports (Complaint ¶¶ 39(a) (Atlanta Journal); 47 (press release); 48 (Aviation Daily); 51 (press release); 52 (press release); 53 (Wall Street Journal); 56 (Associated Press); 57 (company announcement); 58 (public conference call with securities analysts); 95 (Reuters); 60 (press release); 61 (Bloomberg Business News); 63 (Bloomberg Business News); 65 (New York Times)); and (b) public filings and reports (Complaint ¶¶ 41(a) (b) (Form 10-Q); 43(a) (b) (Form 10-Q); 46(a) (b) (c) (Annual Report); 49(a) (b) (Form 10-K); 54(a) (b) (Form 10-Q); 62 (S-4 Registration Statement)).

Because shareholders are not in the class of individuals who may bring a negligent misrepresentation claim based on public statements, and because the only statements relied upon in the Complaint are public statements, the Complaint should be dismissed.

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**C. Plaintiffs Have Failed to State a Claim under the Georgia Securities Act.**

Plaintiffs have failed to state a claim under the Georgia Securities Act for two reasons, each reason arising out of the

differences between the Georgia Securities Act and comparable but not identical federal statutes. First, Plaintiffs have not pled that the transactions at issue are intrastate transactions that occurred in Georgia. The Georgia Securities Act is constitutionally constrained to affect only intrastate transactions. Plaintiffs have not only failed to plead that the transactions are intrastate, but have in fact pled the opposite -- that the transactions are interstate. Second, Plaintiffs have pled neither transactional privity nor individual reliance, at least one and possibly both of which are required under the Georgia Securities Act.

1. **Plaintiff's Claim Should Be Dismissed Because it Concerns Interstate Rather than Intrastate Transactions**

The Complaint in this action is a prime example of the operative differences between the federal and Georgia securities laws schemes. Although federal laws, by their very nature, are directed at *national* markets and *interstate* transactions, state laws, specifically the Georgia Securities Act, are directed at *intrastate* transactions. Accordingly, although the Plaintiffs attempt to state a claim for all transactions in ValuJet, Inc. stock, it is only possible to state such a claim under the Georgia Securities Act for trades occurring in Georgia. Plaintiffs do not plead that their own transactions occurred in Georgia, therefore Plaintiffs' claims must be dismissed.

Since the inception of the Blue Sky Laws at the beginning of this century, it has been held that Blue Sky Laws can only constitutionally pertain to intrastate, and not interstate, transactions. In *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 557-58 (1917), the Supreme Court affirmed the constitutionality of the earliest Blue Sky Laws as follows:

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The next contention of appellees is that the law under review is a burden on interstate commerce, and therefore contravenes the commerce clause of the Constitution of the United States. . . .

The provisions of the law, it will be observed, apply to dispositions of securities within the state . . . It is a police regulation strictly, not affecting them until there is an attempt to make disposition of them within the state. To give them more immunity than this is to give them more immunity than more tangible articles are given, they having no exemption from regulations the purpose of which is to prevent fraud or deception. Such regulations affect interstate commerce in them only incidentally.

242 U.S. at 557-58. *See* Macey & Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 388-89 (1991) (noting that after *Hall*, Blue Sky Laws were ineffective to halt "alternative marketing mechanisms" such as "the mails or other modalities of interstate commerce . . . ultimately leading to the enactment of the Federal Securities Act of 1933.")

The historical dichotomy between the reaches of federal and state statutes explains why the Georgia Securities Act does not reach transactions that do not take place in Georgia. The Georgia Securities Act itself plainly provides that it applies only to sales to "any person in this state." O.C.G.A. § 10-5-5. Indeed, interpreting the Georgia Securities Act, the former Fifth Circuit ruled that when a Georgia resident plaintiff enters into a contract through the mails and over the phone with a Tennessee defendant broker and dealer, the Georgia Securities Act does not govern that transaction. *Rasmussen v. Thomson & McKinnon Auchincloss Kohlmeyer, Inc.*, 608 F.2d 175, 178 (5th Cir.1979) ("the sale did not take place in Georgia").

Plaintiffs' Complaint does not identify a transaction that took place in Georgia. As an initial matter, no Plaintiff identifies any geographic information regarding the transactions pled in the complaint. (Complaint ¶¶ 8-10). Furthermore, all other indications in the Complaint are that Plaintiffs have improperly focussed on interstate commerce and not an intrastate transaction:

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- The identified class is "all persons who purchased the common stock of ValuJet, Inc." and is not limited to those who purchased such stock in Georgia. Complaint ¶¶ 1, 20.
- The defendants are alleged to have "used the mails and the means and instrumentalities of interstate commerce . . . ." Complaint ¶ 7.
- The transactions occurred on a "national securities exchange." Complains ¶ 11(b).
- The identified class is allegedly "located throughout the United States." Complaint ¶ 21.

Because Plaintiffs have not pled a transaction that has occurred in Georgia, Plaintiffs' Complaint should be dismissed.

**2. The Complaint must Be Dismissed as it Pleads Market Wide, as Opposed to Transactional, Fraud.**

Plaintiffs' claims must also be dismissed because Plaintiff has pled neither privity with the Defendants nor actual reliance on alleged misrepresentations by the Defendants. Plaintiffs instead rely on the *federal* doctrine recognizing the fraud-on-the-market presumption of reliance. The fraud-on-the-market doctrine, however, has never been recognized in Georgia or by any other state court interpreting a Blue Sky Law.

The *interstate* scope of federal law allows for the application of market wide theories of liability such as the presumption of reliance afforded by the fraud-on-the-market doctrine. State law is not focussed on market wide fraud, but instead on fraud in individual transactions. In contrasting the merit based state blue sky regulations with the disclosure based federal regulations, one leading commentator noted that "[t]he investing universe contemplated by merit regulation is one in which individual investors confront issuers and promoters directly. . . ."

Sargent, *A Future for Blue Sky Law*, 62 U. Cin. L. Rev. 471, 486-87 (1993).<sup>4</sup>

Some courts have viewed the direct confrontation purpose of Blue Sky Laws as requiring a privity element in private causes of action under the Blue Sky Laws. Other states, while silent as to the issue of privity, have taken the view that direct confrontation requires actual reliance, as opposed to market reliance. No matter which view is taken by the Georgia Courts, Plaintiff has pled neither privity nor reliance, relying exclusively on fraud-on-the-market. (Complaint ¶¶ 26-27 "Applicability of Presumption of Reliance: Fraud-on-the-Market Doctrine.")

As an initial matter, it must be stated that no Georgia Court has ever recognized the validity of the fraud-on-the-market presumption. Accordingly, this Court must create new law, without direction from either the legislature or the appellate courts, before it can permit Plaintiffs to proceed with their claim. Defendants respectfully submit that it is not the province of this

Court to create new theories of action, especially when no other court in the country has recognized the fraud-on-the-market presumption under the Blue Sky Laws.

The Supreme Court of Utah has interpreted Utah's Blue Sky Law, which is similar although not identical to Georgia's, as requiring privity between the plaintiff and the defendant. In *Gohler v. Wood*, 919 P.2d 561 (Utah 1996), the United States District Court certified to the Utah Supreme Court the issue of whether proving fraud-on-the-market satisfied the reliance element of a cause of action under the Utah Blue Sky Laws. The court responded that reliance was not an element of such a cause of action, but that privity was an element:

Privity, which is not an element of the federal implied private cause of action, establishes the necessary link between the alleged misrepresentation and the plaintiff's

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<sup>4</sup>It should be noted that the Georgia Securities Act is not within the general definition of a merit-based Blue Sky Law, and that this comment is more of historical significance.

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injury and therefore serves the same purpose as the reliance requirement of common law fraud and the federal implied cause of action.

919 P.2d at 565-66 (footnote omitted). If this Court were to adopt the Utah rule, then Plaintiffs' Complaint fails to state a claim because it does not plead privity.

Indeed, the Georgia Securities Act provides support for application of the privity requirement. O.C.G.A. § 10-5-14(a), which enables the private right of action under the Georgia Securities Act, is by its own terms restricted to a cause of action

by the "the person buying such security." O.C.G.A. § 10-5-14(a). Such liability attaches only to those who "offer to sell" or make a "sale," (O.C.G.A. § 10-5-12(a)(2)) but does not extend to those who "employ any other deceptive or fraudulent device, scheme, or artifice to manipulate the market in a security." O.C.G.A. § 10-5-12(d)(5). This scheme recognizes the distinction between the direct confrontation between the buyer and seller which is the historic object of the Blue Sky Law and the market manipulation which, while wrongful, is the object of the federal and not the state civil remedy.

Even if this Court chose not to apply the strict privity requirement applied by the Utah Supreme Court, Plaintiffs' claim must still fail for relying solely on the fraud-on-the-market presumption to satisfy the element of reliance. Although this is an issue of first impression in Georgia state courts, the only other state courts that have addressed this issue, while not necessarily imposing a strict privity requirement, have refused to adopt the fraud-on-the-market presumption, or for that matter other presumptions, of reliance.

The Colorado Supreme Court recently reviewed a Colorado appellate decision that raised the issue of whether, assuming that Colorado had adopted the fraud-on-the-market presumption, Colorado

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also adopted the fraud created the market extension of that presumption. The Colorado Supreme Court reviewed the record in the case and found that the plaintiffs had in fact shown actual reliance, pretermittting the question of whether any theory of

presumed reliance was available. However, in dicta, the court explicitly noted that:

Because we conclude that the complaint sufficiently sets forth a claim under section 11-51-125(2), we do not reach the question addressed by the court of appeals as to whether the fraud-created-the-market doctrine should be imported into Colorado law. However, to the extent the court of appeals' opinion is read to assume that that doctrine is a part of our law, we disapprove of that opinion.

*Rosenthal v. Dean Witter Reynolds, Inc.* 908 P.2d 1095 (Colo. 1995).

Florida also restricts the fraud-on-the-market presumption to the federal cause of action: "The appellants' claim, that the brokerage firms engaged in a scheme to defraud the public by creating an artificial market, mimics a fraud-on-the-market claim. Jurisdiction for such actions lies exclusively in the United States District Courts." *Kahler v. E.F. Hutton & Co., Inc.* 558 So.2d 144 (Fla. 3rd Dist. Ct. App. 1990).

The Wisconsin Court of Appeals recently summed up the issue of reliance as follows: "No court has imposed liability for securities fraud based upon a theory of misrepresentation without proof that the investor actually relied on the misrepresented information. We are satisfied that the legislature recognized this principle when it crafted Wisconsin's Blue Sky Laws and hold that our state law requires an investor pursuing a theory of seller misrepresentation to establish reliance." *Carney v. Mantuano*, 554 N.W.2d 854, 855 (Wisc. App. 1996).

Plaintiffs' Complaint should be dismissed with prejudice because of the absence of privity and/or direct reliance allegations.

**D. Plaintiffs' Have Failed to Plead Some Elements of Each Claim, Have Supported Other Elements with Legally Insufficient Allegations, and Have Failed to Plead Others with the Required Level of Particularity.**

Even if this Court disagrees that the claims pled in the Complaint are not recognized by Georgia law, this Court should dismiss the Complaint because it does not adequately set out causes of action for fraud, negligent misrepresentation, or violation of the Georgia Securities Act. The Complaint, despite its undeniable length, does not set forth the elements of these causes of action, either absolutely or with the level of particularity required by law.

Fraud arises when the defendant made a representation or omission of material fact, with knowledge of its falsity, with an intent to deceive, which was actually and reasonably relied upon and which proximately caused damages to the plaintiff. *See generally* 37 C.J.S. Fraud § 3. *See also* *Marriott Corp. v. American Academy of Psychotherapists, Inc.*, 157 Ga. App. 497, 499, 277 S.E.2d 785, 787 (1981) (stating elements of fraud). With the exception of intent, these elements are shared with the claim of negligent misrepresentation, a claim which arises against a defendant:

who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

*Robert & Co. Assoc. v. Rhodes-Haverty Partnership*, 250 Ga. 680, 681, 300 S.E.2d 503, 504, fn. 1 (1983) (citations omitted). Claims under the Georgia Securities Act share these elements, too. *See*

*generally* O.C.G.A. §§ 10-5-12, 10-5-14.

It is also settled that, pursuant to O.C.G.A. § 9-11-9(b), allegations of fraud must be pled with particularity. The identical federal rule has been explained:

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"to further three goals: (1) providing a defendant fair notice of plaintiff's claim, to enable preparation of a defense; (2) protecting a defendant from harm to his reputation or goodwill and (3) reducing the number of strike suits."

*Hershfang v. Citicorp*, 767 F. Supp. 1251, 1254 (S.D.N.Y. 1991) (citation omitted). Plaintiffs' Complaint lacks some elements completely, contains allegations legally inadequate to state the elements, or fails to plead certain elements with the required level of particularity.

Plaintiffs do not identify which Defendants are allegedly liable for what actions. Rather than identify wrongful actions with the Defendants alleged to have taken them, Plaintiffs rely on the mere mention of the word "conspiracy," (Complaint, ¶ 7), and a general allegation that certain individuals may be treated as a group. (Complaint, ¶ 13). Such allegations deprive each Defendant of the right to be put on notice of the allegations made against him. *See, e.g., Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1443 (S.D. Cal. 1988) ("Fraud allegations may not rely on blanket references to conduct of 'defendants and each of them' but must instead inform each defendant of the conduct which constitutes the alleged violation.")

Plaintiffs do not allege misrepresentation or omissions of material fact. Plaintiffs' claims must revolve around *material*

*facts* and cannot be based on opinions, predictions, puffery or similar vague statements that are neither material nor fact. *See, e.g., Gross v. Ideal Pool Corp.*, 181 Ga. App. 483, 485, 352 S.E.2d 806, 808 (1987) ("misrepresentation ... does not include representations as to future acts or events"); *U-Haul Co. of Western Georgia v. Dillard Paper Co.*, 169 Ga. App. 280, 281, 312 S.E.2d 618, 620 (1983) ("The statement of an opinion cannot constitute the basis for a claim of fraud."); *Wilkinson v. Walker*, 143 Ga. App. 838, 240 S.E.2d 210 (1977) (statements by seller that cotton picker was in "good condition" were mere puffing and, thus, were not actionable as fraud). Plaintiffs' Complaint is replete

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with unactionable statements, including vague opinion ("we exceed all standards" (§ 39(a))), puffery ("1995 was a great year" (§ 46(b)) and predictions ("we attempt to achieve the highest level of safety" (§ 53), "we believe that our franchise with the public can be rebuilt" (§ 58)). Such statements are unactionable and accordingly the Complaint should be dismissed.

Plaintiffs do not adequately allege knowledge of falsity. It is not enough to allege that a defendant ought have known a statement was false. *See Derryberry v. Robinson*, 154 Ga. App. 694, 697, 269 S.E.2d 525, 527 (1980) ("Constructive knowledge is not a sufficient basis upon which to predicate an action for fraud."). In this action, Plaintiffs do not plead that Defendants knew in advance of either the unfortunate events surrounding Flight 592 or the temporary suspension of operations that followed.

Plaintiffs do not allege or adequately allege reliance. As

discussed elsewhere, Plaintiffs rely solely on the fraud-on-the-market presumption to allege reliance, which presumption is unrecognized under Georgia law. But furthermore, the face of Plaintiffs' Complaint shows that as a matter of law, Plaintiffs' reliance was unreasonable. *See Lorick v. Na-Churs Plant Food Co.*, 150 Ga. App. 209, 257 S.E.2d 332 (1979) (no actionable fraud where plaintiff had an equal opportunity to investigate salesman's claims that fertilizer would increase crop production). For example, although Plaintiffs' Complaint attempts to make an issue about the age of the ValuJet fleet and use of outside contractors for maintenance, Plaintiffs' Complaint is equally clear that these facts were made known to the investing public through disclosures. (Complaint, ¶ 48.)

Plaintiffs do not adequately allege proximate causation. Clearly the absence of proof of causation justifies a defense judgment, just as the absence of its pleading justifies dismissal. *See, e.g., Ferguson v. Atlantic Land & Development Corp.*, 248 Ga.

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69, 281 S.E.2d 545 (1981) (forgery was not proximate cause of defendant's damages). Even assuming that the Complaint alleges misrepresentations, the Complaint does not correlate those allegations to damages. Instead, the only correlation to a drop in stock price are two events which Plaintiffs cannot seriously contend Defendants could have or should have predicted: an airline accident and a temporary suspension.

#### IV. CONCLUSION.

Plaintiffs' Complaint should be dismissed because it fails to

plead essential elements of the state law causes of action which it purports to advance.<sup>5</sup>

Dated: December 23, 1996  
Atlanta, Georgia

Respectfully submitted,

/s/

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J. Allen Maines  
Ga. Bar No. 466575  
Eric C. Lang  
Ga. Bar No. 435515  
Sharon M. Glenn  
Ga. Bar No. 297305

LONG, ALDRIDGE & NORMAN  
303 Peachtree Street  
Suite 5300  
Atlanta, GA 30308  
404-527-4000

Attorneys for Defendants:  
ValuJet Airlines, Inc., ValuJet, Inc.,  
Michael D. Acks, Timothy Flynn,  
Robert L. Priddy, Lewis Jordan,  
Maurice J. Gallagher, Jr., and  
Stephen C. Nevin

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<sup>5</sup>Defendants also incorporate by reference the defenses asserted in their Answer of this date, including insufficiency of process.

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**CERTIFICATE OF SERVICE**

The undersigned certifies that a true and correct copy of DEFENDANT'S MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED and BRIEF IN SUPPORT has been served upon them by depositing a copy in the U.S. Mail, postage prepaid and addressed as follows:

James L. Bentley, III, Esq.  
Bell & James  
619 Greene Street  
Augusta, GA 30901

Steven G. Schulman, Esq.  
Milberg, Weiss, Bershad, Hynes &

Lerach, LLP  
One Pennsylvania Plaza, 49th floor  
New York, NY 10119

Michael R. Smith  
King & Spalding  
191 Peachtree Street, N.E.  
Atlanta, Georgia 30303

This 23rd day of December, 1996.

/s/

\_\_\_\_\_  
Eric C. Lang

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[director@securities.stanford.edu](mailto:director@securities.stanford.edu)

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