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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH DIVISION

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Case No. 02-80252-CIV-RYSKAMP/VITUNAC

IN RE SAF T LOK, INC.
SECURITIES LITIGATION.
______________________________/

MOTION TO DISMISS CONSOLIDATED AMENDED COMPLAINT: MEMORANDUM OF LAW

Pursuant to Rules 12(b)(6) and 9(b), Federal Rules of Civil Procedure, and 15 U.S.C. § 78u-4(b)(3)(A), defendants Franklin W. Brooks, Jeffrey W. Brooks, William Schmidt, James E. Winner, Jr., and John F. Hornbostel, Jr. (the "Individual Defendants") move to dismiss the consolidated amended complaint (the "complaint"). In support of this motion, the Individual Defendants submit the incorporated memorandum contemporaneously with a Request for Judicial Notice of the relevant financial reports filed by Saf T Lok with the SEC.

INTRODUCTION

The premise of this action is that Saf T Lok overvalued its inventory and related assets in contravention of GAAP for the period April 14, 2000 through April 16, 2001.

Neither count of the complaint states a claim upon which relief can be granted and each should be dismissed with prejudice.

There are two principal grounds for this motion.

First, the claims should be dismissed pursuant to 15 U.S.C. § 78u-4(b)(3)(A) and Rule 9(b) because the complaint fails to allege fraud with sufficient particularity and fails to allege with particularity that each Individual Defendant acted with the requisite scienter.

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Second, any claims for control person liability under 15 U.S.C. § 78t(a) should be dismissed because plaintiff failed sufficiently to allege the requisite underlying securities fraud and plaintiff failed adequately to allege that each Individual Defendant possessed the influence necessary to control Saf T Lok's accounting policies.

As detailed more fully below, the complaint intricately weaves conclusory allegations together with a storybook history of every alleged misstatement Saf T Lok ever published. Although this Court must accept well-pleaded facts as true and draw reasonable inferences in favor of the non-moving party, the Court is not required to accept bald assertions, unsupported legal conclusions, unwarranted inferences and deductions, or legal conclusions cast in the form of factual allegations. Gregory v. Daly, 243 F.3d 687, 692 (2d Cir. 2001); see also Marsh v. Butler County, 268 F.3d 1014, 1036 n.16 (11th Cir. 2001). Further, the complaint is subject to special scrutiny under the Private Securities Litigation Reform Act of 1995 (the "PSLRA" or "Reform Act") because claims alleging securities fraud must satisfy the highest pleading standards.

The complaint does not plead sufficient facts to satisfy the high standards set by the Reform Act.

Accordingly, the claims against the Individual Defendants should be dismissed with prejudice.

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FACTS

The complaint alleges numerous facts that are simply not relevant to the fraud that allegedly occurred during the class period (April 14, 2000 to April 16, 2001). We set forth below the relevant facts derived from Saf T Lok's financial reports filed with the SEC.

Saf T Lok was a company struggling to "catch the wave" of gun safety activism. In an era plagued by violence and shootings, Saf T Lok developed a product that protected handguns against unintended discharge. Saf T Lok held high hopes that activism in the community and a changing political landscape would lead to new laws requiring handgun owners to "lock-up." In turn, Saf T Lok hoped that an expanded market would develop for the company's product. 1999 Annual Report at 12-13 (Request for Judicial Notice, Exhibit 1).

Saf T Lok's gun locks were designed to fit handguns manufactured by industry giants such as Rossi, Ruger, Smith & Wesson, Taurus, Glock, Beretta, Colt, and Sig Sauer. Id. at 2. In total, the locks compatibly secured no fewer than 63 handgun models. Id. At least 38 police departments issued the locks to officers who needed to secure their weapons at home. Id. at 3. Several states were considering legislation requiring handgun locks and, only a few weeks before Saf T Lok filed its 1999 Annual Report, Maryland enacted landmark legislation requiring handgun safety locks statewide. Id. at 13. In March 1999, the company was awarded a five-year General Services Administration contract allowing (but not requiring) federal agencies to purchase Saf T Lok gun locks. Id. at 4. This contract was significant because President Clinton had already issued a directive requiring all federal law enforcement agencies to equip their handguns with child safety locks. Id. at 13.

Investors who purchased Saf T Lok's common stock during the class period were thus aware that the company had an enormous potential for growth.

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The company, however, candidly disclosed that it faced considerable obstacles to establishing itself in the retail market. Saf T Lok's 1999 Annual report indicated that the company faced "a number of not insignificant problems, including the need to continually fund its day to day operating requirements, such as production, wages, and research and development, . . . the ongoing SEC investigation . . . and the need to rework its retail sales capacity following termination of the Distribution Agreement." Id. at 13.

Saf T Lok further disclosed that its sales had "**not yet reached a level sufficient to sustain operations**" and the company therefore was raising cash to stay afloat. Id. at 12 (emphasis added). Accordingly, Saf T Lok also reported that its auditor had issued "**a going concern qualification**" to reflect that substantial doubt existed as to whether the company would be able to maintain operations. Id. (emphasis added).

Saf T Lok believed (based on reasons set forth in its financial statements) that it would be able to realize the carrying value of the inventory through a change in marketing strategy (id. at 3-5) and the addition of a strategic alliance partner (id. at 12). See also Plaintiffs' Exhibit I. Consequently, Saf T Lok classified its inventory as a current asset, which projected that the value of the inventory would be realized within the upcoming 12-month period.[1]

The primary strategic alliance partner that the company pursued was Smith & Wesson. See, e.g., Plaintiffs' Exhibits I, J, and M. The Smith & Wesson merger or acquisition was critically important because it would have created an immediate market for the company's product (i.e., its inventory). 2000 Annual Report at 11 (Request for Judicial Notice, Exhibit 4).

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[1] Under GAAP, a company classifies inventory as a "current asset" to the extent that the inventory is projected "to be realized in cash or sold or consumed" within the upcoming twelve months. See ARB 43, Chap. 3, Sec. A, ¶¶ 4, 5. The value of inventory is the amount that the company reasonably expects to realize from future sales.

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The company, however, did not try to hide behind GAAP. Instead, Saf T Lok plainly indicated to the public that the company was experiencing serious problems. Saf T Lok disclosed that it faced competition from numerous "larger, better capitalized companies" whose gun locks were "more widely known and less expensive than the company's products." 1999 Annual Report at 5. The company also anticipated that competitors with "longer production histor[ies] and existing distribution channels" would develop similar products that might further reduce Saf T Lok's sales and profit margins. Id. at 5. The 1999 Annual Report showed that the company's sustainable sales were insufficient to move the inventory on hand and that the company was in jeopardy as a going concern.[2] Saf T Lok needed to "rework its retail sales capacity" because the company only realized sustainable sales of $67,719 in 1998 and $172,077 in 1999. Id. at 10, 13. The company also more than adequately described its litigation woes with the SEC and with private parties. Id. at 7.

The 1999 Annual Report, filed on April 14, 2000, thus disclosed that the company would be unable to maintain operations beyond mid-2000 without a sufficient increase in revenues, an alliance with a strategic partner, or an influx of capital. 1999 Annual Report at 12.

Saf T Lok investors during the class period knew, therefore, that the company was struggling to survive. Saf T Lok investors also knew that they stood to profit if the company could "catch the wave" of gun safety activism. Investors expected significant returns on their investment if the company could establish a system to market and distribute its products.

Unfortunately, Saf T Lok was not able to capitalize on its efforts to break into the retail market and revenues from sales to government agencies were insufficient for the company to

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2 The company disclosed that sales pursuant to the USA Distribution Agreement were not sustainable. Sustainable sales are those that the company can reasonably expect to recur. Only the sales to government agencies were sustainable.

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maintain operations. And, in December 1999, after the Smith & Wesson deal fell through, it became apparent that the company would not be able to recover the value of its inventory as expected. Id.

On February 21, 2001, James E. Winner, Jr. and John F. Hornbostel, Jr. joined the company's Board of Directors and brought new hope of implementing a successful marketing plan. See Current Report for February 21 (Request for Judicial Notice, Exhibit 2). Winner agreed to serve as the new Chairman and Chief Executive Officer. Id. These new officers joined the company during an ongoing dialogue with the SEC regarding the classification of its inventory and related assets in the 1999 Annual Report. Plaintiffs' Exhibit O. Five days after they joined the company, the SEC determined that the "ultimate net realizable value" did not need to be restated, although the SEC recommended that the company reclassify part of its inventory as "non-current." Id.

Therefore, the company, at the direction of Winner and Hornbostel, reclassified part of the inventory as "non-current" in accordance with the SEC's recommendation and filed on March 26, 2001 an amended 1999 Annual Report (Request for Judicial Notice, Exhibit 3). The company also amended on March 26, 2001 the corresponding first, second and third quarterly reports for 2000. Complaint ¶62. Finally, in its 2000 Annual Report filed on April 16, 2001, the company recognized an impairment loss with respect to the inventory and related assets because the company's business forecasts (including its merger with a strategic alliance partner such as Smith & Wesson) did not come to pass. 2000 Annual Report at 11.

Saf T Lok failed to "catch the wave" of community activism and public interest in preventing the accidental and unauthorized discharge of handguns. Consequently, Saf T Lok's investors were unable to capitalize on their investments and earn the high return that they

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expected from a micro-cap stock. As expected, Saf T Lok's amended financial statements and decline in share price drew the attention of plaintiffs' lawyers. However, fairly reading the financial statements in context, Saf T Lok's valuation of its inventory was not fraudulent and its shareholders are not entitled, under the guise of the federal securities laws, to "insurance" on their investments.

ARGUMENT

THE AMENDED COMPLAINT SHOULD BE DISMISSED WITH PREJUDICE

It is only appropriate to grant a motion to dismiss for failure to state a claim upon which relief can be granted when it appears beyond doubt that the plaintiff can prove no set of facts that would entitle him to relief. Conley v. Gibson, 355 U.S. 41, 45-46 (1957). However, "[c]onclusory allegations and unwarranted deductions of fact are not admitted true in a motion to dismiss." S. Fla. Water Mgmt. Dist. v. Montalvo, 84 F.3d 402, 409 n.10 (11th Cir. 1996). Where the conclusory allegations of a complaint are refuted or revealed to be unfounded by a document that is to be considered in connection with the complaint or judicially noticed, the court need not accept the conflicting allegations and may dismiss the complaint. Gersten v. Rundle, 833 F. Supp. 906, 910 (S.D. Fla. 1993), aff'd, 56 F.3d 1389 (11th Cir. 1995); Associated Builders, Inc. v. Ala. Power Co., 505 F.2d 97, 100 (5th Cir. 1974).

This Court should dismiss the complaint here because the reports filed with the SEC and the documents attached to the complaint refute any allegation of fraud during the class period.

I. The Complaint Does Not Allege Fraud With Particularity.

To state a claim for securities fraud under the Securities Exchange Act § 10b, 15 U.S.C. § 78j, and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, a plaintiff must show: (1) a misstatement or omission; (2) of material fact; (3) made with scienter; (4) on which plaintiff relied; and (5) that

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proximately caused his injury. Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194, 1202 (11th Cir. 2001).

To survive a motion to dismiss, fraud claims must satisfy Rule 9(b). In re Sunbeam Sec. Litig., 89 F. Supp. 2d 1326, 1336 (S.D. Fla. 1999). Rule 9(b) requires the complaint to set forth which statements were made in which documents or oral representations; who made the statements; the content of the statements; the manner in which the statements mislead the plaintiff; and what the defendants "obtained as a consequence of the fraud." Brooks v. Blue Cross and Blue Shield of Florida, Inc., 116 F.3d 1364, 1369 (11th Cir. 1997).

This particularity requirement is heightened under the Reform Act, which was "intended to redress abusive securities litigation in which meritless claims [are] brought in the hope of using the discovery process to uncover evidence of fraud not alleged in the complaint." Malin v. Ivax Corp., 17 F. Supp. 2d 1345, 1352 (S.D. Fla. 1998), aff'd, 226 F.3d 647 (11th Cir. 2000). By passing the Reform Act over President Clinton's veto, Congress implemented procedural safeguards designed to prevent claims that "provided little financial benefit to the claimed victims of the fraud, but fully compensated plaintiffs' lawyers with large fee awards." Malin, 17 F. Supp. 2d at 1352.

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First, under the Reform Act, a plaintiff must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement 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). Second, with respect to any allegation of securities fraud, the plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). If the plaintiff fails to meet these heightened pleading standards, "the court shall, on the motion of any defendant, dismiss the complaint." 15 U.S.C. § 78u-4(b)(3)(A).

The courts in this circuit have appropriately acted as gatekeepers of class action lawsuits against issuers of securities and have not hesitated to dismiss claims that allege "inexcusable negligence" but which fail to allege the "severe recklessness" necessary to constitute fraud. See, e.g., Ziemba, 256 F.3d 1194, 1210 (11th Cir. 2001); Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1281-1285 (11th Cir. 1999).

In the Eleventh Circuit, "severe recklessness" is

> "limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but 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."

Bryant, 187 F.3d at 1282 (quoting McDonald v. Alan Bush Brokerage Co., 863 F.3d 809, 814 (11th Cir. 1989)).

Therefore, to survive a motion to dismiss, the complaint must allege with particularity facts that give rise to a strong inference that **each defendant** acted in a "severely reckless" fashion.

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a. The Complaint Fails Sufficiently To Allege That Saf T Lok's Financial Reports Were Fraudulent.

The complaint here should be dismissed because it fails sufficiently to allege that Saf T Lok's financial statements were fraudulent. Saf T Lok's decision to reclassify the inventory and related assets means that the original financial reports contained inaccuracies, not that the company acted with severe recklessness. Even assuming that the company's original classifications of the inventory as current assets deviated from GAAP, the failure to follow GAAP does not alone establish scienter. Malin, 17 F. Supp. 2d at 1361. Allegations that selected line items in certain financial statements do not conform to GAAP, coupled with allegations of fraud outside of the class period (i.e., the Shalom Weiss allegations), are not sufficient to survive the particularity requirements imposed by Rule 9(b), let alone the Reform Act. Ziemba, 256 F.3d at 1208-1210. "'Boilerplate averments that the accountants violated particular accounting standards'" will not support a strong inference of scienter or survive a motion to dismiss under the Reform Act. Id. at 1209 (quoting Melder v. Morris, 27 F.3d 1097, 1103 (5th Cir. 1994)).

Here, the complaint "has simply seized upon disclosures made in later annual reports and alleged that they should have been made in earlier ones." Denny v. Barber, 576 F.2d 465, 470 (2d Cir. 1978). The accounting equation advocated by the complaint reads as follows: (1) prior misstatements in connection with Shalom Weiss's manipulation of the company increased by (2) a later statement that proves to be incorrect equals (3) securities fraud by the company, its directors, and the independent auditor. However, disagreement about the timing of a write-down is a matter about which reasonable people could disagree and does not create an inference of

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scienter. Echavarri v. Cellstar Corp., Case No. 99-1502-CIV-GRAHAM, slip op. at 25 (S.D. Fla. Sept. 28, 2001).[3] As one court explained:

> A restatement of earnings, without more, does not support a "strong inference" of fraud, or for that matter, a weak one. To reflexively punish a company for correcting its earning statements when subsequent events disclose errors in the originals would create a perverse incentive for management to conceal mistakes, thereby defeating a core purpose of the securities laws.

In re Segue Software, Inc. Sec. Litig., 106 F. Supp. 2d 161, 169 (D. Mass. 2000).

The allegations in the complaint here are substantially similar to the allegations in the complaints in Echavarri and Med/Waste. In those cases, courts in this district found that those complaints alleged that the company "'disclosed through its restatements what it should have discovered and disclosed in the original quarterly reports. This allegation, however, does not support an inference of fraud; rather, it is classic 'fraud by hindsight.'" Echavarri, slip op. at 25 (emphasis original) (quoting Med/Waste Inc. Sec. Litig., Case No. 99-1684-CIV-GOLD, slip op. at 16 (S.D. Fla. Aug. 20, 2000)). Further, the complaint here "fail[s] to analyze statements in context instead of highlighting select parts of larger statements to allege fraud." In re Technical Chemicals Sec. Litig., Case No. 98-7334, 2001 WL 543769, *6 (S.D. Fla. March 20, 2001).

In Ziemba, the Eleventh Circuit found that equating a failure to follow GAAP with securities fraud was a "tenuous inference" that did not satisfy the severe recklessness standard. 256 F.3d at 1210. Even where the allegations raised an "inference of gross negligence," the court in Ziemba found that a misrepresentation was not severely reckless when other disclosures "significantly undermine any hint of fraud." Id. at 1210-1211.

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3 Citing Coates v. Heartland Wireless Comms., Inc., 55 F. Supp. 2d 628, 640 (N.D. Texas 1999); In re Galileo Corp. Shareholders Litig., 127 F. Supp. 2d 251 (D. Mass. 2001).

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Under Ziemba, this Court should find that, even if Saf T Lok deviated from GAAP with respect to the classification of its inventory, there can be no inference of fraud given the entire context of the financial reports, which disclosed that: (1) in 1999, the company realized sustainable sales of less than 10% of the inventory's carrying value; (2) the company faced fierce competition from competitors with better distribution channels and less expensive, more widely known products; (3) the company faced significant marketing, litigation, and cash flow problems; and (4) the company would not be able to continue as a going concern beyond mid-2000 (not coincidentally, the beginning of the class period) without a sufficient revenue increase within three months, joining with a strategic alliance partner, or obtaining an influx of working capital. 1999 Annual Report at 7, 10-13.

In light of the full context of these disclosures, the complaint fails to plead fraud as a matter of law with respect to the few selected line items at issue. It would be inapposite to recognize that Saf T Lok disclosed that it had inadequate revenues, needed to "rework its retail sales capacity," and might fail within three months, but find that the company nevertheless sought to defraud investors as to its ability to sell its entire stock of inventory in the upcoming 12 months. The bottom line here is that Saf-T-Lok investors were on notice that Saf-T-Lok did not have a readily available market for its product, and thus its inventory might not be saleable. In other words, unless certain identified remedial events occurred, the inventory would be worth less in 2000 than it was worth in 1999. The company believed, reasonably, that at least one of these events would occur and the complaint does not allege otherwise. Therefore, the failure to reclassify the inventory in the 1999 Annual Report – even if arguably incorrect under GAAP – and the company's decision not to write down the inventory until it appeared to management none of the remedial events would occur, was not, to paraphrase Ziemba, "a highly unreasonable

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misrepresentation or omission which constitutes an extreme departure from standards of ordinary care. Especially in light of the disclosures actually made, *see infra*, we readily so hold." Ziemba, 256 F.3d at 1211.

Like the complaint in Ziemba, the complaint here fails to allege fraud as a matter of law.

b. The Complaint Fails Sufficiently To Allege That Each Individual Defendant Acted With Severe Recklessness.

The complaint also fails to address critical questions regarding each Individual Defendant's purported knowledge and culpability in the alleged fraud.

To survive a motion to dismiss, the complaint must: (1) state with particularity facts (2) giving rise to a strong inference (3) "**that each separate defendant acted with scienter**" (4) with respect to each alleged misstatement. Sunbeam, 89 F. Supp. 2d at 1236 (emphasis added).

The group pleading doctrine "does not apply to the Reform Act's scienter requirement." Holmes v. Baker, 166 F. Supp. 2d 1362, 1376 (S.D. Fla. 2001); Sunbeam, 89 F. Supp. 2d at 1341. Therefore, the complaint must allege with particularity those allegations that relate to each individual defendant. Holmes, 166 F. Supp. 2d at 1376. Boilerplate references to "them" and "they" are to be disregarded. Id.

"It is well-established that '[a]llegations that a director or officer signed public disclosures and/or was involved in the company's daily operations, standing alone, will not satisfy the pleading requirements of the PSLRA or Rule 9(b).'" Cheney, 2000 WL at *9; see also In re Criime Mae, Inc. Sec. Litig., 94 F. Supp. 2d 652, 661 (D. Md. 2000) (allegations that individual defendants controlled a company's day-to-day operations, signed public filings with the SEC, and were "privy to confidential proprietary information" held insufficient to plead scienter"); In re Advanta Corp., 180 F.3d 525, 539 (3d Cir. 1999) (allegations that because of his

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position within company, a defendant "must have known" that a statement was false are "precisely the types of inferences which [courts] on numerous occasions have determined to be inadequate").

The complaint here fails adequately to allege that each Individual Defendant knew or was severely reckless in failing to discover "the falsity of the Company's statements *at the time* the misstatements were made." Med/Waste, 99-1684-CIV-GOLD, slip op. at 11 (S.D. Fla. Aug. 30, 2000) (emphasis original). The complaint relies heavily on allegedly wrongful acts that occurred prior to the class period.[4] Then, the complaint fast forwards to allegations that the company knew its inventory was impaired in April 2001. This pleading method does not satisfy the Reform Act's rigorous standards.

> The Court must reject this hindsight approach to alleging fraud. To explain why a statement is fraudulent, 'the complaint must set forth an explanation as to why the disputed statement was untrue or misleading *when made* . . . . This can be done most directly by pointing to inconsistent *contemporaneous* statements or information (such as internal reports) which were made by or available to the defendants.'

Technical Chemicals, 2001 WL at *6 (emphasis original).

When alleging that Saf T Lok and its directors "*knew*" that the company's inventory "could not be sold through [sic]," the complaint cites correspondence among the defendants that occurred six months after the time period to which the last allegedly fraudulent statement relates. Complaint ¶64 (emphasis in original).

> [I]t is well established that plaintiffs in a securities action have not alleged actionable fraud if their claim rests on the assumption that the defendants must have known of the severity of their problems earlier because conditions became so bad later on.

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4 Complaint ¶¶ 4-8, 30-46. The first allegation regarding the class period begins at paragraph 47.

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Rhodes v. Omega Research, Inc., 38 F. Supp. 2d 1353, 1363 (S.D. Fla. 1999).

The last period for which the company allegedly misstates the value of its inventory is the period ending September 30, 2000. Id. at ¶62. There is no dispute that the company and its officers knew in April 2001 that its inventory was impaired. To establish that, the complaint would only have to reference the 2000 Annual Report, which states at page 10 that "as 2000 drew to a close management realized that events over which they had no control, would likely result in the inability to realize the value of the inventory within a predictable period of time." That is why the "smoking gun" letters from Schmidt to Hornbostel and Goldberg to Hornbostel are not relevant to this action.

The only relevant inquiries here are: (1) whether the **original** officers (Franklin W. Brooks, Jeffery W. Brooks, and Schmidt) acted in a severely reckless fashion by failing to write-down the value of its inventory and related assets in the 1999 Annual Report and 2000 quarterly reports; and (2) whether the **new** officers (Winner and Hornbostel) were severely reckless in failing to determine the original error (if any).

By way of illustration, consider a 1999 Annual Report that relates to the fiscal year ended December 31, 1999. If management later determines that the report, when published, contained an inaccurate statement, then management has a duty to amend the statement that was inaccurate at the time the report was published. However, if management restates an item in a report dating back several years, management is not required to restate every projection, every forecast, every estimate, every valuation, and every outlook that has turned out to be incorrect. Rather, management is required to correct only those statements that the company knew or should have known were inaccurate at the time they were published. In other words, all periodic financial reports have a strong temporal element and show the company's progress over time. If

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management were required to bring an entire past report "up-to-date" each time it amended select statements in a past report, then all amended reports would arguably be inaccurate depending on when they were restated.

Here, for instance, Winner and Hornbostel (the **new** officers) could only be liable if (1) the former management's statements were inaccurate when made and (2) Winner and Hornbostel knew (or were severely reckless in not knowing) that the former management's statements were inaccurate. Therefore, Winner and Hornbostel did not act in a severely reckless fashion by publishing the restated reports unless: (1) the 1999 reports constituted an extreme departure from ordinary care because the inventory was so obviously worthless in 1999 that the company, its auditors, and directors should have so known; and (2) Winner and Hornbostel acted with severe recklessness when they failed to discern (within the short period of weeks after they joined the company) that the value of the inventory was misstated in the prior year. Bryant, 187 F.3d at 1284.

Thus, for the counts alleging wrongdoing against Winner and Hornbostel to survive a motion to dismiss under the Reform Act, this Court would have to find that the complaint: (1) alleged with particularity that (2) Winner and Hornbostel (3) each acted in a highly unreasonable fashion (4) by failing to ascertain (5) within one month of joining the company (6) that the company's valuations of its inventory and related assets were fraudulent when made. As the Eleventh Court stated in Ziemba:

> On the basis of the allegations here, **this series of inferences is too tenuous** to amount to one of 'those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care."

Ziemba, 256 F.3d at 1210.

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Analyzing the specific allegations against each of the Individual Defendants reveals that the complaint fails to plead scienter with particularity as to any of them.

1. **The Claims Against Winner Should Be Dismissed.**

Remarkably, the only paragraphs of the complaint that even reference Winner are: (1) paragraph 20, which incorrectly[5] states that he was the Chairman of the Board of Directors, President and Chief Executive Officer effective February 21, 2001 (less than two months before the end of the class period); and (2) paragraph 67, which alleges that Winner signed the 2000 Annual Report **correcting the alleged misstatement** by writing down the value of the inventory. As a matter of law and logic, the plaintiffs cannot successfully assert a securities fraud action against a corporate officer by merely citing his status as an officer and alleging that he signed an Annual Report correcting an alleged misstatement previously made.

2. **The Claims Against Hornbostel Should Be Dismissed.**

With regard to Hornbostel, who also joined the company less than two months before the end of the class period, the only allegations of wrongdoing are that he: (1) signed the amended reports on March 26, 2001 in accordance with the SEC recommendation; (2) received several letters in April 2001 from the company's auditor and a former officer explaining that GAAP also would require the company to write-down the values of the inventory and related assets in the 2000 Annual Report; and (3) signed the 2000 Annual Report disclosing that the inventory and related assets were impaired. The complaint thus does not satisfy the pleading requirement for scienter as against Hornbostel because it does not allege that Hornbostel knew that the original statements were false when made (only that he purportedly knew in March 2001 that the

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[5] See Current Report for February 21, 2001.

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inventory was impaired, which is not relevant because that is six months after the last period in question).

3. The Claims Against Schmidt Should Be Dismissed.

With regard to Schmidt, the complaint only alleges that he signed the 1999 Annual Report in his capacity as an officer and director and communicated to Hornbostel on April 4, 2001 that the inventory was impaired. Complaint, ¶¶ 20, 72, 109, 144, 210. The law is abundantly clear that these allegations are insufficient to plead with particularity that Schmidt committed securities fraud.

4. The Claims Against Jeffrey W. Brooks Should Be Dismissed.

With regard to Jeffrey W. Brooks, the complaint only alleges with particularity that he signed the 1999 Annual Report in his capacity as an officer and director. Complaint, ¶¶ 20, 72. The only other place where the name "Jeffrey W. Brooks" even appears in the complaint is the heading of Count II. Complaint at page 79. Again, this is not sufficiently particular to satisfy even the pre Reform Act pleading requirements.

5. Claims Against Franklin W. Brooks Should Be Dismissed.

Concerning Franklin W. Brooks, the complaint alleges with great particularity his **previous** misstatements in connection with Shalom Weiss. Those misstatements are irrelevant to this action. The complaint utterly fails to allege with particularity any facts that give rise to a strong inference that Franklin W. Brooks actually knew or was severely reckless in failing to know that Saf T Lok should have written down the inventory and related assets for 1999 or 2000.

The complaint relies almost exclusively on allegations that the company made certain misstatements prior to the class period, engaged in business with a man it would later discover was a notorious felon, and failed to promptly write down its inventory and related assets. The

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previous wrongdoing of John L. Gardner and Shalom Weiss is alleged with more particularity than the purported fraud committed by Franklin W. Brooks or any of the Individual Defendants.

II. The Complaint Fails To State A Claim For Control Person Liability.

The claims under § 20(a) of the Exchange Act should be dismissed as against all of the Individual Defendants because the underlying securities fraud is not adequately pled. Brown v. Enstar Group, Inc., 84 F.3d 393, 396-397 (11th Cir. 1996) ("Of course, without a primary violation of the securities laws, there can be no secondary violation under § 20(a).").

Even if this Court were to find that fraud had been adequately plead, the complaint still fails to state a claim for control person liability against Winner and Hornbostel.

To state a claim under § 20(a), the plaintiff had to allege that: (1) Saf T Lok violated § 10b; (2) each Individual Defendant had the power to control the general affairs of Saf T Lok; and (3) each Individual Defendant "'had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in primary liability.'" Theoharous v. Fong, 256 F.3d 1219, 1227 (11th Cir. 2001) (citing Brown, 84 F.3d at 396).

In Theoharous, plaintiffs' counsel argued in the Eleventh Circuit that a minority shareholder should be liable under § 20(a). The court held that even if the plaintiff in Theoharous had alleged a violation of § 10(b), which he did not, that a minority shareholder did not have "the power to control or influence the 'specific corporate policy which resulted in' the alleged misconduct." Id. at 1228. Rejecting the plaintiff's arguments in Theoharous, the court relied on the definition of the term "control," found in 17 C.F.R. § 230.405:

> The term control . . . means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

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Here, with respect to Winner and Hornbostel, the complaint does not allege that they controlled the company or the specific policies that resulted in the alleged misstatements for 1999 or first three quarters of 2000. The only action taken by Hornbostel and Winner was to cause the company to comply with the SEC recommendation regarding the classification of certain inventory as a non-current asset and ultimately write down the inventory and related assets. Winner and Hornbostel accomplished all of this within weeks of joining the company. Consequently, there can be no control liability during their tenure.

CONCLUSION

For the foregoing reasons, the Individual Defendants respectfully request that this Court dismiss the plaintiff's complaint with prejudice.

Dated: November 11, 2002

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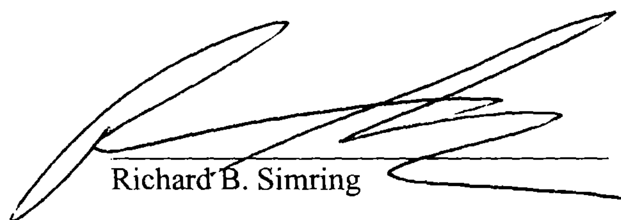
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was served by **Facsimile** (without exhibits) and **Federal Express** (with exhibits) on this 11th day of November, 2002 on **Kenneth J. Vianale, Esq.**, Milberg Weiss Bershad Hynes & Lerach, LLP, 5355 Town Center Road, Suite 900, Boca Raton, Florida 33486; and **Pete L. DeMahy, Esq.**, DeMahy, Labrador & Drake, P.A., The Colonnade, Suite 550, 2333 Ponce de Leon Blvd., Coral Gables, Florida 33134.



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