IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

Securities and Exchange Commission, Plaintiff, v. Cavco Industries Incorporated, et al., Defendants.	No. CV-21-01507-PHX-SRB **ORDER**

The Court now considers Defendants Cavco Industries, Inc. ("Cavco") and Daniel Urness's ("Urness") (collectively, "Defendants") separate Motions to Dismiss the Security and Exchange Commission's ("SEC") Complaint. (Doc. 13, ("Cavco Mot."); Doc. 15, "Urness Mot.").)

I. BACKGROUND

This case arises out of Defendants' alleged involvement with insider trading. (Doc. 1, Compl. ¶ 4.) A large public company specializing in home manufacturing, Cavco often holds in excess of $100 million in liquid assets. (Cavco Mot at 2.) Cavco authorized its former CEO, Joseph Stegmayer ("Stegmayer"), to invest Cavco's surplus cash—no other employee had this authority. (Compl. ¶¶ 61–62.) In August 2017, Stegmayer and Urness, Cavco's CFO, began discussions with Skyline Corp. ("Skyline"), a competing public corporation, regarding Cavco's potential acquisition of Skyline. (*Id.* ¶ 38.) On September 19, 2017, after signing a nondisclosure agreement and receiving nonpublic information from Skyline, Cavco offered to purchase Skyline for $13.50 per share. (*Id.* ¶¶ 45–46, 60.)

The following day, Stegmayer began using Cavco's surplus cash to buy Skyline stock. (*Id.* ¶ 63.) On September 26, 2017, Skyline representatives indicated that Cavco's offer was "significantly behind other options." (*Id.* ¶ 71.) After this rejection, Stegmayer continued to purchase Skyline stock for Cavco, and Cavco ultimately purchased 34,730 shares of Skyline for slightly under $400,000. (*Id.* ¶¶ 73–76.) When Skyline merged with another company in January 2018, its value rose from $12.83 to $19 per share, resulting in an unrealized $260,459 gain for Cavco. (*Id.* ¶ 82.)

Cavco maintained policies to control corporate investing ("Investment Policy") and prevent insider trading ("Insider Trading Policy"). (*Id.* ¶ 5.) Per the Investment Policy, Cavco generally invests surplus cash assets in low-risk cash equivalents. (*Id.* ¶ 14.) If the CEO sought to invest Cavco funds in anything outside the Investment Policy, the CEO had to obtain pre-approval for the investment from Cavco's CFO and Board of Directors ("Board"). (*Id.*) Cavco's Insider Trading Policy mandated that:

> [n]o employee or director of the Company . . . may buy, sell or otherwise trade in the securities of the Company while such [person] . . . possess[es] material non-public information concerning the Company. . . . This policy applies to public securities of other companies where the person learns of the information through his connection with Cavco.

(*Id.* ¶ 27.)

In early March 2017, Stegmayer began purchasing stock for Cavco in Nobility Homes, a publicly traded company with which Cavco was in merger talks. (*Id.* ¶¶ 87–95.) Stegmayer notified Urness about these trades and Urness arranged for the funds to be wired to Cavco's brokerage account. (*Id.* ¶¶ 93, 96.) Urness never notified the Board of these stock purchases. (*Id.* ¶ 101.) Urness, after approving several purchases, established a new process within the accounting department to fund Cavco's trades. (*See id.* ¶¶ 102, 170.) As described by the SEC, Urness's new process "did not include any role for Urness to review or approve the trades or the wires funding the trades" and consequently "there were no procedures at all to review or approve [Cavco's] trades." (*Id.* ¶¶ 102–03, 177.) Two days after Urness's implementation of the new process, Stegmayer purchased an additional $232,260 worth of shares. (*Id.* ¶ 108.) Stegmayer continued to purchase Nobility Homes

shares for Cavco throughout their eventually unsuccessful negotiations, and thereafter he repeated this strategy by purchasing shares of two other companies that Cavco was confidentially considering for acquisition. (*Id.* ¶¶ 109, 116–43, 145–49.) Stegmayer's trades were never reported to Cavco's Board in advance of trading. (*Id.* ¶¶ 103, 115, 144, 150.)

Notwithstanding Cavco's policies prohibiting his conduct, Stegmayer succeeded in using Cavco's funds to make illegal Skyline trades, and regulators began to investigate the situation. (*Id.* ¶¶ 76, 199–200.) In February 2018, the Financial Industry Regulatory Authority ("FINRA") contacted Cavco seeking details about Cavco's contacts with Skyline. (*Id.* ¶¶ 200–01.) Cavco responded via a letter, reviewed by Urness, in which it denied making an offer to purchase Skyline and made no mention of the Stegmayer trades. (*Id.* ¶¶ 211–12.) In April and May 2018, Cavco's auditor interviewed Urness regarding Cavco's involvement with Skyline and contact with any regulatory agencies. (*Id.* ¶¶ 213–41.) Urness did not disclose the existence of the FINRA investigation or the Skyline trading to Cavco's auditor. (*Id.*)

The SEC asserts that Urness set up a funding process that enabled Cavco to place trades without his review or approval and included no checks to ensure the trades complied with Cavco's Policies, despite Urness's responsibilities under the Investment Policy. (*Id.* ¶¶ 103, 177.) The SEC also alleges that Urness lied in a corporate audit about Cavco's insider trading and the FINRA investigation. (*Id.* ¶¶ 207–08, 213, 224, 229–30.) Further, the SEC avers that Cavco fraudulently purchased Skyline securities and failed to implement an adequate mechanism to prevent insider trading. (*Id.* ¶¶ 265–72.) These allegations give rise to five claims: two against Cavco for insider trading and inadequate accounting controls, and three against Urness for aiding and abetting Cavco's inadequate controls, circumventing or failing to implement controls, and misleading Cavco's auditor. (*Id.* ¶¶ 265–88.)[1]

Cavco and Urness separately filed Rule 12(b)(6) motions to dismiss the Complaint

[1] The SEC also brought claims against Stegmayer, but he was terminated in this action after reaching a consent judgment with the SEC. (Doc. 8, Consent J. as to Stegmayer.)

on November 2, 2021. (*See* Cavco Mot.; Urness Mot.) Regarding its alleged insider trading, Cavco asserts that Stegmayer was not acting within the scope of his employment as CEO of Cavco when he made the illegal trades, and therefore Cavco is not liable for the insider trading. (Cavco Mot. at 7–9.) Cavco also contends that the SEC has not adequately pled that Cavco's accounting controls were insufficient. (*Id.* at 9–11.) For his part, Urness argues, *inter alia*, that the SEC has not pled facts to establish an inference of scienter, which is necessary to allege the Counts against him. (Urness Mot. at 2.) The SEC filed their Responses on December 3, 2021, and Cavco and Urness filed their Replies on December 20, 2021. (Doc. 17, Resp. in Opp'n to Cavco Mot. ("Resp. re Cavco"); Doc. 18, Resp. in Opp'n to Urness Mot. ("Resp. re Urness"); Doc. 19, Urness Reply in Supp't of Urness Mot. ("Urness Reply"); Doc. 20, Cavco Reply in Supp't of Cavco Mot. ("Cavco Reply").) The Court held oral argument on the Motions on January 6, 2021. (Doc. 24, Min. Entry.)

II. LEGAL STANDARD & ANALYSIS

Rule 12(b)(6) dismissal for failure to state a claim can be based on either (1) the lack of a cognizable legal theory or (2) insufficient facts to support a cognizable legal claim. *Conservation Force v. Salazar*, 646 F.3d 1240, 1242 (9th Cir. 2011). In evaluating a 12(b)(6) motion, "[a]ll of the facts alleged in the complaint are presumed true, and the pleadings are construed in the light most favorable to the nonmoving party." *Bates v. Mortg. Elec. Registration Sys., Inc.*, 694 F.3d 1076, 1080 (9th Cir. 2012). "[A] well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and 'that a recovery is very remote and unlikely.'" *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007) (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974)). However, "for a complaint to survive a motion to dismiss, the nonconclusory 'factual content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief." *Moss v. U.S. Secret Serv.*, 572 F.3d 962, 969 (9th Cir. 2009) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).

When a complaint includes allegations of fraud, Rule 9(b) requires the plaintiff to "state with particularity the circumstances constituting fraud." This means the plaintiff

must detail the "time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation." *Edwards v. Marin Park, Inc.*, 356 F.3d 1058, 1066 (9th Cir. 2004) (citation omitted). "To comply with Rule 9(b), allegations of fraud must be specific enough to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Bly–Magee v. California*, 236 F.3d 1014, 1019 (9th Cir. 2001) (internal quotations omitted). In contrast, "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Fed. R. Civ. P. 9(b).

A. Cavco's Motion to Dismiss

Cavco argues that the SEC has inadequately pled its claims for securities fraud in violation of § 10(b) of the Exchange Act and insufficient accounting controls in violation of § 13(b)(2)(B) of the Exchange Act. (Cavco Mot. at 2.) The Court disagrees.

First, Cavco asserts that the securities fraud claim should be dismissed because the SEC has not sufficiently pled its vicarious liability for Stegmayer's insider trading. (*Id.* at 4, 7.) Cavco mischaracterizes the Complaint and the relevant law. Within the Ninth Circuit, there is "a general rule of imputation . . . a corporation is responsible for a corporate officer's fraud committed 'within the scope of his employment' or 'for a misleading statement made by an employee or other agent who has actual or apparent authority.'" *In re ChinaCast Educ. Corp. Sec. Litig.*, 809 F.3d 471, 476 (9th Cir. 2015) (quoting *Hollinger v. Titan Cap. Corp.*, 914 F.2d 1564, 1577 n.28 (9th Cir. 1990)). This corporate responsibility is direct—it does not arise from a theory of vicarious liability. *See, e.g.*, *id.* at 475. The SEC alleges that Cavco is primarily liable, not vicariously liable, for the fraudulent Skyline trades. (Resp. re Cavco at 1.) The SEC details that as CEO, Stegmayer was not only authorized to make trades on Cavco's behalf, but he "was the *only* person who had the ability to place trades in Cavco's brokerage accounts." (Compl. ¶¶ 61–62) (emphasis added). Cavco counters that Stegmayer acted outside the scope of his employment because he failed to follow corporate procedure when placing the trades.

(Cavco Mot. at 8.) The Court disagrees and finds that the Complaint adequately alleges facts demonstrating Stegmayer acted within the scope of his authority to make the illegal trades.

The SEC specifically pleads that Cavco's insider trading of Skyline shares was but one episode in a series of allegedly illegal trades that Stegmayer made on behalf of Cavco during his tenure as CEO. (*Id.* ¶¶ 63–66, 73–75, 90, 95, 108–09, 112, 119, 121–22, 124–25, 130, 132, 140, 148.) Cavco emphasizes that Stegmayer was not authorized to engage in the trading at issue and that an executive title alone is not sufficient to impute Stegmayer's scienter to Cavco. (*See* Cavco Mot. at 8–9.) The Court rejects Cavco's contentions as inconsistent with binding precedent. *See, e.g.*, *ChinaCast*, 809 F.3d at 476 (restating Ninth Circuit rule regarding imputation of a corporate officer's fraud). Taken as true, the SEC's detailed allegations regarding Stegmayer's serial use of his authority for Cavco's insider trading raise a reasonable inference that Cavco violated § 10(b).

Second, despite Cavco's assertions that its accounting controls were reasonable and it thereby bears no responsibility for Stegmayer's circumvention, the Court finds that the SEC has stated a claim for an accounting controls violation. Section 13(b)(2)(B) requires that security issuers "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; . . . [and] (iii) access to assets is permitted only in accordance with management's general or specific authorization." 15 U.S.C. § 78m(b)(2)(B)(i), (iii). A "reasonable" degree of assurance under § 13(b)(2) is one that "would satisfy prudent officials in the conduct of their own affairs." *Id.* § 78m(b)(7). The SEC alleges specific shortcomings in Cavco's controls—that there were insufficient checks for how investments outside the Policy would be identified and reported and for how improper investments would be prevented—and provides concrete examples of how these controls and their implementation could have been improved. (*See* Compl. ¶¶ 99–106, 164–98.) These allegations plausibly suggest that Cavco's controls did not provide the "reasonable" assurances required by § 13(b)(2)(B).

Cavco repeatedly reframes factual disputes as claims that the SEC misunderstands the law. Evaluating if a company provided "reasonable assurances" under § 13(b)(2)(B)'s "prudent official" standard is a "fact-intensive inquiry" and should generally be left to the fact-finder. *See SEC v. e-Smart Techs., Inc.*, 82 F. Supp. 3d 97, 114 (D.D.C. 2015) (citing *SEC v. Black*, No. 04 C 7377, 2008 WL 4394891, at *15 (N.D. Ill. Sept. 24, 2008)). Cavco objects to the SEC's examples of how Cavco should have maintained adequate accounting controls, reasoning that by the SEC's logic, any circumvention of accounting controls is caused by inadequate controls. (Cavco Mot. at 11.) The SEC's argument is not so sweeping—it clarifies that circumvention alone is not the basis for their § 13(b)(2)(B) claim. (Resp. re Cavco at 13.) "[A]lthough the Investment and Insider Trading policies constitute internal accounting controls[2] which Urness and Stegmayer circumvented, the SEC also alleges that such controls alone could not provide the reasonable assurances required under Section 13(b)(2)(B)." (*Id.* (citing Compl. ¶¶ 166–71).)

B. Urness's Motion to Dismiss

Urness asserts that the SEC has failed to state claims against him for aiding and abetting Cavco's violation of § 13(b)(2)(B), circumventing or failing to implement a system of accounting controls in violation of § 13(b)(5), and misleading an auditor in violation of Rule 13b2-2. (Urness Mot. at 9–16.) Once again, the Court disagrees.

Urness argues that the SEC has not adequately alleged any of the three elements necessary for an aiding and abetting claim. (Urness Mot. at 9–13.) To state a claim for aiding and abetting a violation of § 13(b)(2)(B), the Complaint must allege: (1) a primary controls violation occurred; (2) the defendant had actual knowledge or reckless disregard of the primary violation and his role in furthering it; and (3) the defendant substantially

[2] Cavco—and, to a certain extent, Urness—assert that Cavco's Insider Trading Policy does not constitute an accounting control per § 13(b)(2)(B). (Cavco Mot. at 15; Urness Mot. at 9.) Both Defendants fail to adequately substantiate this point. Cavco relies upon two inapposite and unpersuasive authorities: first, *In re Ikon Off. Sols., Inc.*, 277 F.3d 658, 672 n.14 (3d Cir. 2002) is merely a non-binding footnote that includes ensuring the reliability of records as a possible, but not a mandatory, function of accounting controls. Second, the analysis in *In re Elan Corp. Sec. Litig.*, 543 F. Supp. 2d 187, 223 (S.D.N.Y. 2008) related to a company allegedly misleading investors, not insider trading—its distinct facts undermine any persuasive power the decision might have had. Urness does not cite any authority for his argument in this respect.

assisted in committing the primary violation. *See S.E.C. v. Fehn*, 97 F.3d 1276, 1288 (9th Cir. 1996); 15 U.S.C. § 78t(e). A defendant substantially assists when he "(1) associates himself with the venture; (2) participates in it as something [he] wish[es] to bring about; and (3) seeks to make the venture succeed by [his] action." *SEC v. Premier Holding Corp.*, No. CV 18-00813-CJC, 2019 WL 8167920, at *7 (C.D. Cal. Dec. 10, 2019).

As described above, the Court already found that the SEC has stated a claim for a primary violation. Turning to the second element, Urness mistakenly suggests that the SEC must allege that he knowingly furthered Cavco's § 13(b)(2)(B) violation. (Urness Mot. at 10–11.) On the contrary, the Court finds that the SEC has adequately pled that Urness at least recklessly disregarded his substantial role in furthering Cavco's primary violation. (*E.g.*, Compl. ¶¶ 102–03, 151, 180 (alleging that Urness knew about his duty to review Cavco trades, was aware that certain trading was prohibited, and received Cavco's quarterly investment reports).) To plead Urness's substantial assistance, the SEC alleges that Urness affirmatively abandoned his duty to review Cavco's trading, most notably when he allegedly created a system through which Stegmayer could place trades for Cavco with "no procedures at all to review" the trades. (*Id.* ¶¶ 100–03.) Urness refutes these allegations, but such disputes of fact are not appropriate for resolution on a 12(b)(6) motion to dismiss. (*See* Urness Mot. at 10–12; Urness Reply at 5–6.)[3]

Despite Urness's protestations that the SEC has not adequately pled his state of mind, the Court also finds that the SEC has made a claim for a § 13(b)(5) violation against Urness. (Urness Mot. at 14.) To violate § 13(b)(5), a defendant must "knowingly circumvent or knowingly fail to implement a system of internal accounting controls." 15 U.S.C. § 78m(b)(5). The SEC contends that the allegations supporting its aiding and abetting claim also substantiate its § 13(b)(5) claim, namely that Urness knowingly established a process by which Cavco could make investments outside the Policy without

[3] Urness also argues that to substantially assist in a § 13(b)(2)(B) violation, or later to directly violate § 13(b)(5), the violations must have an "adverse impact on the reliability of Cavco's financial reporting." (Urness Mot. at 13–14.) The SEC counters, and the Court agrees, that "to require a financial misstatement in order to state a claim would be to impose a materiality requirement where none exists." (Resp. re Urness at 14 (citing *S.E.C. v. World–Wide Coin Invs., Ltd.*, 567 F. Supp. 724, 748–50 (N.D. Ga.1983)).)

Urness's or the Board's approval. (Resp. re Urness at 14.) Without citing any authority, Urness responds that his "open" discussion of implementing the new trade monitoring system in March 2017 indicates that he did not know his behavior could lead to circumvention. (Urness Mot. at 14.) The Court disagrees and finds that SEC has stated a claim against Urness for violating § 13(b)(5).

Finally, regarding the alleged Rule 13b2-2 violation, Urness continues to challenge the SEC's averments of his scienter. Rule 13b2-2(a) mandates that "[n]o director or officer of an issuer shall, directly or indirectly . . . [m]ake or cause to be made a materially false or misleading statement . . . or omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made . . . not misleading, to an accountant in connection with" audits, reviews, or examinations. 17 C.F.R. § 240.13b2–2. "The question of materiality . . . is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable [auditor]." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976). Though Urness contends that the SEC fails to allege he was even aware of the insider trading during the period when he spoke to Cavco's auditor, he ignores the detailed allegations "that Urness knew of Cavco's insider trading no later than February 2018, by which point he had received quarterly trading reports showing Cavco's holdings in Skyline as well as the FINRA investigation request regarding suspected insider trading in Skyline." (Urness Mot. at 15; Resp. re Urness at 16 (citing Compl. ¶¶ 222–24).) Further, Urness argues that any statement or omission he allegedly made to Cavco's auditor was immaterial. (Urness Mot. at 15–16.) The SEC correctly asserts that Urness cites no meaningful support for this assertion, and indeed courts within the Ninth Circuit have found similar allegations to be material in the context of a 13b2-2 violation. (Resp. re Urness at 17 (citing *SEC v. Retail Pro, Inc.*, 673 F. Supp. 2d 1108, 1142–43 (S.D. Cal. 2009)); *see also SEC v. Baxter*, No. C-05-03843 RMW, 2007 WL 2013958, at *9 (N.D. Cal. July 11, 2007). The Court finds that the SEC has stated a claim that Urness lied to Cavco's auditor in violation of Rule 13b2-2.

III. CONCLUSION

Applying both Rule 12(b)(6) and 9(b) pleading standards where appropriate, the Court finds that the SEC has stated its claims against Cavco and Urness.

IT IS ORDERED denying Cavco's 12(b)(6) Motion to Dismiss (Doc. 13).

IT IS FURTHER ORDERED denying Urness's 12(b)(6) Motion to Dismiss (Doc. 15).

Dated this 25th day of January, 2022.

Susan R. Bolton
United States District Judge