

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

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* * * * * C.A. NO. 16-107M
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SECURITIES AND EXCHANGE *
COMMISSION *
VS. * JUNE 11, 2019
* 2:00 P.M.
*
RHODE ISLAND COMMERCE *
CORPORATION, formerly known *
as Rhode Island Economic *
Development Corporation, et al *
* * * * * PROVIDENCE, RI

BEFORE THE HONORABLE JOHN J. McCONNELL, JR.,
DISTRICT JUDGE

(Motion for Summary Judgment)

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APPEARANCES:

FOR THE PLAINTIFF: KATHLEEN BURDETTE SHIELDS, ESQ.
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1 11 JUNE 2019 -- 2:00 P.M.

2 THE COURT: Good afternoon, everyone. We're
3 here this afternoon on Defendant Peter Cannava's motion
4 for summary judgment in the case of Securities and
5 Exchange Commission versus the Rhode Island Commerce
6 Corporation, et al, Civil Action 16-107.

7 Would counsel identify themselves for the
8 record.

9 MR. KELLY: Good afternoon. Brian Kelly and
10 Kathleen Burns on behalf of Mr. Cannava as well as
11 Charles Dell'Anno, Steve LaRose and, of course, Chuck.

12 THE COURT: Of course.

13 MS. SHIELDS: Good afternoon, your Honor. I'm
14 Kathleen Shields for the Securities and Exchange
15 Commission, and with me is Louis Randazzo.

16 THE COURT: Great. Welcome back, Ms. Shields, I
17 think. Right?

18 MS. SHIELDS: Yes. Thank you.

19 THE COURT: Mr. Kelly?

20 MR. KELLY: Yes, your Honor. Do you prefer me
21 up there?

22 THE COURT: I don't really care, per se, but
23 it's best for the court reporter if that's where you
24 would argue from, not to toss Karen under the bus.

25 MR. KELLY: Thank you. Your Honor, we're here

1 today on a summary judgment motion in a case which
2 began almost nine years ago. The bond transaction at
3 issue here closed in November of 19 -- well, 2010, and
4 the issues --

5 THE COURT: Other than the Rhode Island
6 taxpayers, Mr. Cannava is the last person standing in
7 the 38 Studios saga from the way I see it.

8 MR. KELLY: Yes, he is the last man standing.
9 In fact, he's the only individual from Wells Fargo who
10 got thrown into this mess, and that's part of our
11 motion, your Honor.

12 He was part of a large working group. In other
13 words, there were lawyers involved, there were other
14 executives from Wells Fargo involved, there were
15 financial people, and they spent hours and hours
16 working on this 300-page bond document, the so-called
17 PPM.

18 It's not as though Mr. Cannava on his own
19 decided what should be disclosed or what shouldn't be
20 disclosed. He was working hand in glove with lawyers,
21 other executives, and that's all important as you'll
22 hear as we go along because that goes to his mental
23 state.

24 And in this case, in this motion, I think there
25 are two important cases and two important legal issues,

1 your Honor.

2 THE COURT: Should I guess them?

3 MR. KELLY: I'm sorry?

4 THE COURT: I said should I guess them?

5 MR. KELLY: Materiality and recklessness. And,
6 your Honor, with respect to the materiality -- I have
7 to read this, and I can't read anymore because of my
8 eyes.

9 With respect to materiality, the First Circuit
10 in *Flannery* has been clear that for something to be
11 material, there must be a substantial likelihood that
12 the disclosure of the omitted fact would have been
13 viewed by the reasonable investor as having
14 significantly altered the total mix of information
15 available.

16 Of course, the First Circuit in *Flannery* is
17 following the Supreme Court's case in *Basic*. And
18 that's a key point here on both of the two issues
19 before the Court, and that is the SEC wants the Court
20 to believe that this one omitted fact about 38 Studios'
21 financial condition somehow could have significantly
22 altered the mix of information.

23 THE COURT: Well, I mean, you know, the finances
24 of a company that's the subject of bonds issuing is
25 a -- it's not like they, you know, didn't disclose the

1 color of the car that was involved.

2 I mean, it's not absurd for the Government to
3 believe that the finances of the underlying company
4 were significant to investors. And I know your
5 argument about the guaranty and the insurance and all,
6 but I don't think you can slough off on the Government
7 their belief that the finances of 38 Studios was an
8 important factor that should be properly disclosed in a
9 PPM.

10 MR. KELLY: Correct, your Honor, and that's why
11 the PPM itself had innumerable disclosures about the
12 financial condition of 38 Studios. They go on and on
13 and on about the various defects in this company.

14 Any objective investor, not even the so-called
15 sophisticated investors who signed the big boy letters
16 in this case, any investor could read that 300-page PPM
17 and say this company, 38 Studios, is kind of shaky.

18 THE COURT: By the way, just for the number of
19 interns that are in here, "big boys letters" is
20 actually a legal term.

21 MR. KELLY: Maybe we should now say big person
22 letters; but they are signed, in fact, by the
23 sophisticated investing companies. It's not just some
24 mom-and-pop investor in Pawtucket who bought this.
25 These are professional investors. They signed the big

1 boy letters. They knew what they were getting into.

2 And anybody, though, could read this PPM because
3 it was replete with warnings about 38 Studios'
4 financial condition.

5 And, your Honor, the issue with respect to
6 38 Studios, the financial conditions were fully
7 explained. In fact, if you don't mind, I'll go through
8 some of them quickly or not. If the Court's --

9 THE COURT: You can do anything you want,
10 Mr. Kelly. I don't -- as you may or may not have
11 heard, I don't try to try cases or argue cases for
12 attorneys that are before me, but it does seem to me
13 that a greater focus on Mr. Cannava's role in this and
14 the Government's proof that they've put forward on that
15 might intrigue me more.

16 MR. KELLY: Yes. With respect to Mr. Cannava,
17 again, part of a large working group. He spent
18 substantial time on this matter. And as with virtually
19 everyone involved in this, it was his view, perhaps
20 mistaken, but it was his view that the important credit
21 was the State of Rhode Island's moral obligation. It
22 wasn't the financial conditions of 38 Studios, not that
23 that wasn't important and not that it wasn't disclosed
24 ad nauseam, but --

25 THE COURT: Yeah, the Government -- the SEC

1 refers to it as kind of boilerplate language about the
2 financial condition of 38 Studios, but there wasn't the
3 detail of what has been called the funding gap in all
4 of this, that is, the difference between the \$75
5 million needed to finish Copernicus and the \$50 million
6 that they were going to get from the bonds.

7 MR. KELLY: Well, I mean, the one thing they've
8 been good at in this case is putting sinister labels on
9 things that are otherwise not very exceptionally --

10 THE COURT: I'm going to pause you there and
11 tell you that the SEC has been excellent in lawyering
12 this case from this Court's perspective.

13 MR. KELLY: And the so-called funding gap is a
14 creation of the SEC. The front page of the PPM, it
15 describes what the money's for. It doesn't talk about
16 Copernicus, one video game.

17 They want to drill down to one minor aspect of
18 the finances of 38 Studios, and they're just saying
19 that one omission is somehow material here, somehow
20 would have altered the total mix of information to an
21 objective investor. It's just not accurate.

22 And what is accurate is that, from Cannava's
23 perspective, the material credit was the state's moral
24 obligation. Anything more would have been gilding the
25 lily on 38 Studios.

1 And it's not just Cannava. Moody's and S&P when
2 they rated it, all they looked at was the moral
3 obligation from the state, not the financial condition
4 of 38 Studios.

5 So it's not as though Mr. Cannava was off the
6 reservation and just assuming it was the state's credit
7 that was important. That was from Moody's, that was
8 from S&P, that was from his bosses.

9 Again, at the time of this, he was a 30-year-old
10 mid-level banker. Now he's not 30 years old anymore,
11 but he had then and he still has a great reputation for
12 diligence in doing everything necessary to get a matter
13 like this transacted.

14 And when the Court analyzes it, not only does it
15 have to look at materiality, but it has to look at
16 recklessness because, as the Court may well remember,
17 the SEC initially charged this on a negligence-based
18 theory. The case was thrown out, and they just simply
19 refiled, and now they're alleging recklessness.

20 They're not even alleging intentional. They're
21 alleging recklessness. And in this circuit,
22 recklessness is not easy to establish.

23 THE COURT: Right. The *Fyfe* case I think sets
24 off a pretty high standard; but, Mr. Kelly, why doesn't
25 the combination of evidence that's before the Court

1 with the testimony and affidavits of the SEC's experts
2 about the standard of care within the industry, why
3 doesn't that get the SEC to a jury?

4 MR. KELLY: It doesn't, your Honor, because the
5 expert -- their own expert opinion alone is not enough
6 to create a disputed fact.

7 THE COURT: You know, help me out there,
8 Mr. Kelly, because you allege that a number of times in
9 your brief. And, mind you, I went back to look at it
10 again in preparation today to find that because I
11 thought about that fact and I couldn't find anything
12 other than the uncited assertion that that's the case.

13 So don't worry right now. You can get back up
14 or you can send it or you can tell it to me later, but
15 I didn't find a case that stands for the proposition
16 that an expert opinion about the industry standards
17 and/or the Defendant's violation of it alone is
18 insufficient.

19 MR. KELLY: Okay. I'll pull that case for you
20 momentarily, your Honor. But I think one of the points
21 I'm trying to make with respect to his scienter, his
22 state of mind, whether or not he was reckless, that's
23 how the Court can decide this because there's no
24 evidence that, under the First Circuit law, he ignored
25 warnings or hid things from disclosure.

1 He didn't disregard any obvious danger of
2 misleading investors because, here's the critical
3 point, no investor was misled. The SEC has yet to
4 identify, and maybe they will today, any single
5 investor who was misled. Zero.

6 THE COURT: But the SEC points out that that is
7 not their mandate. Their mandate is to root out
8 misrepresentations in the financial industry whether or
9 not investors acted in a certain fashion.

10 I mean, you make very excellent points, kind of
11 depressing points to a Rhode Island taxpayer, that the
12 investors would reinvest again. Right? And you point
13 out that it was a -- in fact, it turns out to be a good
14 investment, and one said he wished he had a bigger
15 piece of it because it's produced so well for the
16 investors.

17 But the SEC says that really isn't relevant to
18 their mission. Their mission is to ferret out
19 misrepresentations in the system to keep the system
20 appropriately pure; and so whether investors were, in
21 fact, misled or not isn't a relevant factor.

22 MR. KELLY: Your Honor, I think that's a real
23 stretch to say our mandate is to protect the investing
24 public and then no investors were misled, no investors
25 lost a penny. In fact, as the Court noted, the actual

1 investors made money.

2 The taxpayers may have suffered, but that was
3 not Mr. Cannava's doing. That was the political
4 decisions of the politicians at the time, not his
5 doing.

6 His job was to shepherd this bond transaction
7 through the system, and he did the best he could. If
8 he made a mistake or if he should have known this or he
9 should have done more, that's the language of
10 negligence.

11 There is no evidence, zero evidence that he was
12 reckless in any way, in any way. In fact, a good
13 example of his lack of recklessness and the fact that
14 he's not a reckless actor comes with respect to the
15 so-called, again, good label, the dual master issue and
16 whether or not he should have inquired further.

17 Of course he knew the equity people were not
18 working for free, but he didn't know the terms of the
19 milestone payments in the letter. And what I'm -- the
20 point is, he -- it was him and him alone who pointed
21 out the so-called dual master to Wells Fargo.

22 If the Court will indulge me on that point, I'd
23 like to put up a quick exhibit that shows this lack of
24 recklessness. I'd like to put up page 20 and then 21
25 because that shows hopefully to the Court that it's

1 Cannava.

2 He's the one in late October of 2010 who's
3 notifying compliance executives who are also working on
4 this deal that -- Hrinkevich there is his supervisor,
5 again, part of the large working group on this, and
6 it's Cannava who tells him in subparagraph --
7 subsection 2 there we're being paid additional fees
8 from the company that we need to assure are paid
9 properly and in compliance with fee disclosure.

10 So he's handing the ball to compliance people
11 because he doesn't know the nuances of fee disclosure.
12 And because he does that, the compliance team at Wells
13 Fargo puts it in the final PPM.

14 If you see the next page, page 20 -- yeah, the
15 50,000 is referenced. That's his handiwork. That is
16 not the work of a man who's recklessly ignoring red
17 flags. It's the work of someone trying to be diligent,
18 who is working with a big group, who knows
19 coincidentally that bond counsel, respected bond
20 counsel with a respected Rhode Island firm, Pannone
21 Lopes, they went through the due diligence files which
22 had this engagement letter in it.

23 And that's not a specific advice of defense --
24 advice of counsel defense. It simply goes to his state
25 of mind, and it undermines any suggestion that he was a

1 reckless actor.

2 THE COURT: What do you say about the fact that
3 Mr. Cannava admits or the SEC says there's evidence
4 that he admits, perhaps in his deposition or somewhere,
5 that he had knowledge of -- I'm going to go back to the
6 funding gap issue.

7 MR. KELLY: Sure.

8 THE COURT: That he had knowledge of the funding
9 gap issue and failed to disclose it in the PPM.

10 MR. KELLY: Your Honor, I would say if -- if he
11 was mistaken, that is, if he should have disclosed it
12 because he improperly thought the real credit that
13 mattered was the State of Rhode Island, well, it's a
14 mistake. It may even be --

15 THE COURT: You know, under your theory,
16 Mr. Kelly, they shouldn't have mentioned anything about
17 the finances of 38 Studios.

18 MR. KELLY: No, I'm not willing to go that far.

19 THE COURT: No, but that's what you seem to
20 imply because the fact is, if Mr. Cannava had knowledge
21 of a funding gap on the major singular project that was
22 going to make or break 38 Studios, that is the project
23 Copernicus, and he knew of a major funding gap, a third
24 of the funding, right, 75 million versus 50 million,
25 and he didn't disclose that and your argument to me is

1 that everyone knew that, you know, Rhode Island's moral
2 obligations, which we haven't even talked about yet,
3 and the fact that there was a real question whether we
4 were going to honor our moral obligations or not in
5 this state, but put that away, why would you say
6 anything about other than that we would expect full
7 disclosure?

8 MR. KELLY: Okay. Maybe I'm not making myself
9 clear. With respect to his belief that the State of
10 Rhode Island was the main credit and, therefore, that
11 should be the focus, if he's wrong, he's wrong. He's
12 not reckless because Moody's and S&P thought the same
13 thing.

14 With respect to -- I'm not saying there
15 shouldn't have been any disclosures about 38 Studios
16 because there was. There was disclosures in spades
17 about 38 Studios, about poor financial conditions.
18 There was a going concern letter from a big auditing
19 company, PWC.

20 In fact, what I'm saying is, to the extent there
21 were investors, these mythical investors out there that
22 the SEC is worried about who would have wanted to know
23 that, the investors who did not invest who cared about
24 38 Studios, those are the ones who walked away.

25 You see the list of -- the SEC goes on and on

1 about, you know, a half a dozen people who said these
2 are terrible investments, look at 38 Studios, blah,
3 blah, blah.

4 Yeah. That's because the PPM did its job,
5 because it warned everybody, look, 38 Studios is kind
6 of a shaky company, but the credit's over here; but if
7 you really cared, you were an investor who cared about
8 38 Studios, you walked away.

9 If you didn't care about them, you invested.
10 That's what the actual investors say. They were
11 concerned with the State of Rhode Island and the
12 insurance. They invested. They made money. It didn't
13 matter to them about 38 Studios. To the extent it did
14 matter to the potential investors who walked away, they
15 walked away.

16 So the point is, what would one additional
17 negative fact mean? They'd still walk away. They
18 walked away. Tell one more bad thing about 38 Studios,
19 so what? How does that alter the total mix of
20 information under the Supreme Court's case in *Basic*?
21 That's why this is ripe for summary judgment. It
22 doesn't. That's why it's not material.

23 THE COURT: And that's regardless of whether
24 experts in the field believe that Mr. Cannava violated
25 his professional responsibilities within the industry?

1 MR. KELLY: Well, as I said, their paid expert
2 standing alone is not enough, but even if you --

3 THE COURT: You sound like me in my old days,
4 Mr. Kelly. I never used the word "expert" without the
5 word "paid" before it because --

6 MR. KELLY: Well, you were successful.
7 Hopefully it will happen here as well.

8 THE COURT: I liked to do that. But you know
9 what I found out over years of interviewing jurors
10 after 25 years of trying cases was, jurors don't care
11 whether the person's paid or not. I used to think it
12 was the biggest deal in the world when I tried cases.

13 MR. KELLY: Even cooperating witnesses for the
14 Government, it doesn't really matter.

15 THE COURT: No, no. It doesn't seem to. They
16 seem to have a real knack at getting at the truth
17 regardless; but anyway, I digress. Go ahead.

18 MR. KELLY: So yes. So with respect to the
19 funding, it's our position it's clear in the PPM it was
20 disclosed. To the extent there was an additional bad
21 fact about the finances of 38 Studios, so what? It
22 doesn't alter the total mix.

23 THE COURT: But let me go back to the one that I
24 deviated on, which is -- and it's your position as a
25 matter of law even in light of this evidence of

1 violating industry standards that the Court can grant
2 summary judgment?

3 MR. KELLY: Because -- yes, because it was just
4 a mistake.

5 THE COURT: Tell me why.

6 MR. KELLY: If he was negligent in not complying
7 with what the SEC's expert thinks is the standard,
8 okay. Even if it's an excusable neglect. Okay.
9 That's not the standard.

10 THE COURT: I don't think that's what the expert
11 called it. I've got a lot of papers here, but I'm not
12 sure if I brought that with me. I thought the expert
13 referred to it in far harsher term than excusable
14 neglect.

15 MR. KELLY: Well, you know, I'll get you that
16 cite as well when I get the case; but the point is, in
17 his mind, Cannava's mind, his scienter, he thought what
18 mattered most was the State of Rhode Island, just like
19 Moody's did.

20 THE COURT: Right, but SEC points out that it's
21 not an objective standard, it's a subjective standard.

22 MR. KELLY: And subjective, okay, how about S&P
23 and Moody's? They're pretty neutral. They thought the
24 same thing. So the point is --

25 THE COURT: Let me tell you this, Mr. Kelly.

1 There is no question in my mind that you have made out
2 an excellent case for Mr. Cannava. Period.

3 The question that's before the Court is, has the
4 SEC made out a sufficient enough case that the question
5 should go to a jury. And that's what I'm trying to
6 focus on, is there's no question you have laid out as
7 good a case as anyone could be represented by here, and
8 hats off to you and your entire team for doing that.

9 But focus on the Government's evidence that they
10 have that would entitle them to have this decided by a
11 jury. And, to me, one of the biggest is, amongst
12 others that they have that I'm sure we'll hear from,
13 has to do with their experts -- their expert.

14 MR. KELLY: They have zero evidence that the
15 addition of this one piece of information about
16 38 Studios affected or would have affected anyone. No
17 one has said that.

18 And that's why it's not material. They have
19 zero evidence that he was reckless under the First
20 Circuit law. He may be many things, but he's not
21 reckless, and that's why it warrants summary judgment
22 here.

23 THE COURT: So I can ignore the expert
24 testimony?

25 MR. KELLY: The expert --

1 THE COURT: I should ignore it?

2 MR. KELLY: You should ignore it.

3 THE COURT: Why?

4 MR. KELLY: Under the case law that we cited, we
5 don't think it's compelling, and it doesn't make any
6 sense. How does it make -- if the expert just comes in
7 and says XYZ, it makes no sense, the Court doesn't have
8 to listen to it.

9 How does it make any sense for him to say, boy,
10 that one omission about 38 Studios altered the total
11 mix and the people who didn't invest, they really
12 wouldn't have invested this time?

13 It makes no sense because the people who didn't
14 invest weren't going to invest if they cared about
15 38 Studios. The people who wanted to invest, they
16 could care less about 38 Studios. They cared about the
17 state. The state was on the hook. The state's still
18 on the hook.

19 THE COURT: Well, maybe.

20 MR. KELLY: Well, if the state's not on the
21 hook, they've got insurance, and so they're still
22 getting their seven percent with the investment. Some
23 of these guys wanted more, but that's not Mr. Cannava's
24 duty.

25 He was one of many people, and that goes to his

1 scienter as well. He was one of many people working
2 this. They're trying to isolate him as one little guy
3 dragged into this Wells Fargo debacle.

4 And, you know, Wells Fargo settled. Well, the
5 standard's different. It's negligence. And they're a
6 big company. That's their regulator. They have to
7 capitulate at a certain point.

8 THE COURT: Right. I don't know whether I'm
9 allowed to consider this or not, you can tell me if I
10 can or not, but while it's a different standard,
11 negligence versus reckless and knowing, between Wells
12 Fargo and its employee, for the negligence of Wells
13 Fargo to have been actionable, the material that they
14 were negligent on had to be material.

15 MR. KELLY: Well, as I understand --

16 THE COURT: So, in other words, Wells Fargo in
17 settling with the SEC, they, in fact, acknowledged that
18 the omitted material was -- the omitted matters were
19 material?

20 MR. KELLY: I think they disputed it, but they
21 neither admit nor deny settlement. So they paid the
22 money, and they walked away.

23 Mr. Cannava, it's his career. It's his
24 livelihood. He can't just do that. He can't just
25 write a check and admit something that didn't happen,

1 nor did Wells Fargo admit it apparently; but he didn't
2 do it.

3 He's, like, I was not reckless. I did the best
4 I could here. He's the one who caused the so-called
5 dual master to be disclosed with respect to the fees.
6 He's the one who sent that e-mail.

7 So even though -- his own lawyers at Pannone
8 Lopes, they didn't flag this as an issue. It was in
9 the due diligence files. You know, that's -- it's as
10 clear as day, I think.

11 If I can look at one question, your Honor, if
12 there are any other points. Well, yeah, okay. There's
13 one more point on this fee issue, so-called equity
14 milestone payments.

15 Again, it wasn't just his view that these --
16 this equity matter was separate from the bond deal. It
17 was the boss, not just his supervisor but the boss of
18 the Wells Fargo Public Finance Department, Exhibit 24,
19 Peter Hill. He testified. Yeah, I wouldn't have
20 disclosed it. I still wouldn't have disclosed it
21 because it's not part of the bond deal. It's part of
22 the equity deal.

23 Now, maybe they're wrong. Maybe they should
24 have thought of it as something that should have been
25 disclosed. That's, again, the language of negligence.

1 It's a mistake. It's not reckless by Cannava, whose
2 big boss thinks the same way he does.

3 Cannava is the one who pushes the 50 grand into
4 the disclosure, and the equity engagement letter was
5 reviewed by his lawyers, Wells Fargo's lawyers.

6 So at least with respect to that one, your
7 Honor, I don't think the expert for the SEC can just
8 wave his magic wand and say, oh, there's disputed
9 facts, therefore we need a trial. That one I think is
10 clear as day.

11 Now, going back to the -- they like to call it
12 the funding gap. I like to call it, like, one small
13 aspect of 38 Studios' finances because it is only one
14 small aspect of 38 Studios' finances.

15 The front page of the PPM tells the whole world,
16 including these investors, what the money is for.
17 There's no mention of this one game. There's a mention
18 of relocation from Mass. to Rhode Island. There's a
19 mention of creating a studio in Rhode Island.

20 And, in fact, they reference games, plural.
21 They don't just say Copernicus. They say video games,
22 plural. So there's no single emphasis on one video
23 game which the SEC wants the Court to think is the case
24 to heighten the importance of this one omission.

25 So I would say I would get back to the point

1 with respect to the so-called funding gap that, look,
2 one more negative fact about 38 Studios wouldn't have
3 made a difference to anyone.

4 People who cared about it walked away. They
5 still would have walked away if they got more negative
6 information. And the people who didn't care about it,
7 they invested.

8 So for those reasons, your Honor, I think you
9 should grant summary judgment for Mr. Cannava.

10 THE COURT: Mr. Kelly, thank you.

11 Ms. Shields.

12 MS. SHIELDS: It takes me a little longer than
13 it usually does.

14 THE COURT: Take your time. Take your time.
15 Oh, my goodness. Are you okay?

16 MS. SHIELDS: I'm fine. I had ACL surgery a
17 while ago. I'm getting better.

18 THE COURT: Good. Good luck.

19 MS. SHIELDS: Thank you.

20 THE COURT: Would you rather sit? You can
21 argue --

22 MS. SHIELDS: I'd actually rather stand. It's
23 easier to stand sometimes than to sit.

24 So good afternoon. I'm Kathleen Shields on
25 behalf of the SEC with Lou Randazzo. I'd like to

1 respond to a couple of the points that Mr. Kelly made
2 and then answer your Honor's questions because I'm sure
3 you have them for us.

4 So maybe to -- this is a bit out of order, but
5 I'll start with the exhibit that Mr. Kelly showed you.
6 It's Exhibit 89, the e-mail about the \$50,000
7 disclosure fee. And I think that's very telling
8 because I think Mr. Kelly is suggesting that this
9 e-mail relates to the fees in the side agreement, but
10 it doesn't.

11 So this e-mail relates to that \$50,000
12 disclosure fee that was negotiated between Peter
13 Cannava and the EDC that ultimately was disclosed in
14 the PPM, and I think the reason this sort of --

15 THE COURT: That's not the 50,000 equity fee?

16 MS. SHIELDS: So there is no 50,000 equity fee.
17 So in the side agreement, what 38 Studios agreed to pay
18 Wells Fargo was \$400,000, \$25,000 that was due and
19 owing on the day of the first meeting between the EDC
20 and 38 Studios, \$75,000 on the day that 38 Studios
21 decided to abandon the equity offering in favor of the
22 bond offering, and then \$300,000 in the closing of the
23 bond transaction. So that \$400,000 set of payments
24 were the payments that were not disclosed in the PPM
25 and that the SEC argues should have been disclosed.

1 What Peter Cannava asked his compliance
2 department about was a different fee. So there was a
3 \$50,000 fee that Cannava asked the EDC to pay to Wells
4 Fargo for basically using the disclosures in the equity
5 PPM that Wells Fargo had prepared, the work that was
6 done by Mark Lamarre and his team.

7 And so they negotiated back and forth over that;
8 and the EDC agreed that as part of the bond closing,
9 Wells Fargo could get an extra \$50,000 for that work
10 and 38 Studios would pay it.

11 And so that was something that everybody sort of
12 knew about and was discussed, and Peter Cannava asked
13 his compliance folks about it. They said, apparently,
14 disclose it, and it was disclosed.

15 But I think what that episode teaches us is that
16 Peter Cannava clearly knew that these additional kinds
17 of fees were important and he knew about the side
18 agreement fees. And I think where you see his
19 recklessness or his knowing misconduct is that he
20 didn't go to compliance to even ask about that
21 additional \$400,000 in fees.

22 He didn't seek advice. He didn't get advice.
23 He couldn't have followed advice he didn't get. And so
24 I think it's somewhat faffle to say that this episode
25 is evidence of good faith because when faced with the

1 far more significant question of whether to disclose a
2 side agreement that reveals a significant conflict of
3 interest and is dealing with a far more substantial
4 amount of fees, he didn't take any of those steps.

5 So another thing that Mr. Kelly talked about
6 was, from Peter Cannava's perspective, that the
7 relevant credit was the state's credit. And he made a
8 bunch of statement about what Moody's thought and what
9 Moody's agreed, and I would dispute that. I think
10 we've presented you with evidence, we've presented the
11 Moody's report, and it does talk about 38 Studios.

12 Of course it pays attention. The rating
13 agencies have sort of established rating criteria that
14 of course pay attention to the State of Rhode Island's
15 moral obligation guaranty; but Moody's did take into
16 account a number of things about 38 Studios, its
17 financial condition, its industry, the essentiality of
18 the project, and Moody's does talk about all of those
19 things.

20 For him to say that his sort of perspective was
21 blessed by Moody's is definitely a stretch on the
22 record that you have before you.

23 And then I think what is perhaps the most
24 troubling is the set of arguments that Mr. Kelly has
25 made about the materiality standard because I think

1 there are a couple of important ways in which his and
2 Mr. Cannava's arguments get that standard wrong.

3 Materiality, it's very clear from the case law
4 it is to be judged at the time of the transaction, that
5 investors' profits simply don't matter, whether
6 investors lose money or make money, and that even more
7 importantly information does not need to be outcome
8 determinative to an investor's decision in order to be
9 material.

10 THE COURT: What level does it have to be to
11 meet material, then, when you're confronted with, what
12 is it, six investors here, I think, six institutional
13 investors, all of whom testified that this additional
14 missing two pieces of information, the funding gap and
15 the side agreement, wouldn't have changed their mind
16 and they're perfectly happy?

17 Why can't the -- why isn't that our own little
18 private focus group that tells us whether that
19 information is material or not?

20 MS. SHIELDS: There are sort of two answers to
21 that. The first is that the statutes under which the
22 SEC charged Mr. Cannava were for aiding and abetting
23 violations of Section 17(a)(2) and (3).

24 Now, Section 17(a)(2) and (3) are statutes that
25 relate to the offering of securities. They are

1 statutes that are designed to prevent fraud in the
2 offering, misrepresentations, deceptive acts and
3 practices in the offering. And offerings are broad.
4 They go to many, many investors.

5 And so to say that you're going to evaluate
6 materiality based only on a subset of potential
7 investors out there who actually decide to purchase a
8 particular investment is sort of drawing a very small
9 circle in the universe of potential investors and
10 saying that you're going to privilege the perspective
11 of those particular investors who decided to take a
12 risk that others didn't take. And when you look at
13 what the purpose --

14 THE COURT: So it is an unrepresented focus
15 group.

16 MS. SHIELDS: It is an unrepresented focus
17 group, and it also ignores the purpose of that statute
18 because the statute is designed broadly to prevent
19 fraud and deception in the offering more broadly of
20 securities.

21 There are different statutes that focus much
22 more on the purchase and the sale of securities. Those
23 are not statutes under which Mr. Cannava's charged. So
24 I think those arguments might be slightly different,
25 but they're inapplicable in the 17(a) context.

1 The second thing I'd say is that it is somewhat
2 of a -- there is one of those existing investors who
3 did say that the fact that there was a side agreement
4 between Wells Fargo and 38 Studios under which there
5 was a complicated relationship and under which Wells
6 Fargo would have gotten more fees was something that he
7 thought should have been disclosed and that he would
8 have wanted to know.

9 And then going back to I think the other
10 question you asked me, so what's the standard, if
11 information doesn't need to be outcome determinative in
12 order to be material, what does it need to be?

13 And I think the answer is, either from *Flannery*
14 or from *Basic*, the Supreme Court's opinion, it needs to
15 be significant in the investment deliberations of an
16 investor.

17 And I think the reason that the -- both pieces
18 of information in this case are material is because
19 they would have mattered because 38 Studios' finances
20 and its financial condition were clearly important to a
21 number of prospective investors.

22 And when you're talking about a major hole in
23 38 Studios' finances and creditworthiness, you can't
24 say that that didn't matter in analyzing whether
25 38 Studios was a creditworthy investment. The fact

1 that they might have made the same decision isn't the
2 standard.

3 THE COURT: That -- let me grab it because I
4 want to get the language exactly. One has to come to
5 some inferences on the -- I know Mr. Kelly doesn't like
6 the term, but we're going to use it anyway -- the
7 funding gap count that you bring that requires some
8 inferences that I clearly allowed you at the time when
9 we argued this years ago now, I guess, right, and you
10 have to take that statement -- and unfortunately I
11 can't find it exactly here, but you have to take the
12 statement that the SEC found violative of the statute
13 and you have to infer in order to find that it's
14 misleading.

15 MS. SHIELDS: So is your Honor referring to --
16 so there are two particular statements in the bond PPM.
17 There's also an omission.

18 THE COURT: Right.

19 MS. SHIELDS: So there's one statement that says
20 that 38 Studios has a going concern opinion from its
21 auditor, and then there's another one that says that
22 38 Studios is dependent upon the proceeds of these
23 bonds to -- for the future completion of Copernicus.

24 THE COURT: Correct.

25 MS. SHIELDS: And so you're right. That

1 statement does not say that these bond proceeds will be
2 enough to finish the game, but it says that 38 Studios
3 is dependent on those proceeds.

4 And it's the SEC's view and supported by a line
5 of cases that talk about half-truths that when you say
6 something but leave out a significant piece of the
7 story that would complete that thought, that can be
8 just as misleading as a lie. It's the SEC's view that
9 that statement is one of those half-truths.

10 The investors are told 38 Studios is dependent
11 on the proceeds of these bonds but is not told, by the
12 way, those proceeds are grossly insufficient.

13 So there's also the aspect of the bond PPM as a
14 whole omitting the funding gap completely. It's not in
15 there anywhere. And so while there are two misleading
16 statements, there is also a misleading omission.

17 There was -- I think one of the other points
18 that Mr. Kelly raised that I wanted to respond to is,
19 he describes Mr. Cannava a couple of times as a little
20 guy or someone who got dragged into this, and that's
21 simply not what the record reflects in this case.

22 Mr. Cannava was a senior banker on this
23 transaction. He was excited to have that role.

24 THE COURT: A 30-year-old senior banker?

25 MS. SHIELDS: He sold -- he stepped up and sold

1 himself as being that person on this deal.

2 THE COURT: What good 30-year-old in the finance
3 industry doesn't do that?

4 MS. SHIELDS: Absolutely.

5 THE COURT: Like how many vice presidents of
6 banks are there?

7 MS. SHIELDS: I think for him, I think he saw
8 this as his opportunity in a sort of pop
9 culture-filled, celebrity-studded deal to make a big
10 splash. And so the SEC sued Mr. Cannava because it
11 looked at the facts and decided that he was the person
12 who was the most responsible on this transaction for
13 the mistakes and the problems with it.

14 The SEC doesn't try to pick on people. They
15 look at the -- at what actually happened in the case.
16 And if you look at who had responsibility in this case,
17 he may have been 30, he may have been 40, whatever age
18 he was, he was the person with the responsibility for
19 making sure that the disclosure in this PPM was fair
20 and accurate and complete.

21 THE COURT: What's your response, Ms. Shields,
22 you deal with it in your papers a lot, but articulate
23 for me why Mr. Kelly's argument that Mr. Cannava's the
24 breadth of the people he turned to, the professionals
25 that he turned to, whether it be the lawyers or

1 financiers or others, showed that he acted far less
2 than recklessly, in fact he acted in a professionally
3 appropriate manner, in determining what the PPM should
4 say.

5 MS. SHIELDS: So I think there are a couple of
6 things I'd say about that, and I think the first thing
7 is that Mr. Cannava is trying to make a
8 reliance-on-others defense without establishing any of
9 the requirements of that defense.

10 He wants you to believe that the mere presence
11 of other professionals on the transaction in some way
12 absolved him of his responsibilities despite the fact
13 that he never asked them for any advice.

14 THE COURT: No, I don't think he's making that
15 argument. I think his argument is more nuanced than
16 that, and his argument -- or maybe it's not. Maybe
17 it's more in your face than that, actually.

18 His argument is that I did what a professional
19 person in my shoes should have done at that time. I
20 turned to professionals for counsel, advice, overview,
21 insight and whatnot of the breadth of people I should
22 be looking at, lawyers and financiers and supervisors
23 and whatnot, and that that goes to his scienter; that
24 is, that that goes to show that he did not act
25 recklessly, in fact he acted professionally because

1 that's what professionals do. I think that's really
2 why he raises that.

3 MS. SHIELDS: What I would say in response to
4 that is, the evidence is that he did not turn to others
5 to seek advice or counsel about the -- these questions.

6 THE COURT: Tell me about that.

7 MS. SHIELDS: So there is absolutely no evidence
8 that he asked anyone, lawyer, financier, boss,
9 compliance, anyone, for advice about disclosure of the
10 side agreement fees.

11 His counsel, his outside counsel, didn't know
12 about that agreement and those fees. He didn't present
13 those fees or that agreement to anyone in Wells Fargo's
14 internal compliance department.

15 He didn't ask anyone at the RIEDC whether those
16 fees should be disclosed. They didn't even know about
17 it. RIEDC's financial advisor didn't learn about the
18 existence of that agreement until there was a lawsuit
19 filed relating to the transaction.

20 So I think there is a leap being made in that
21 argument that presumes Mr. Cannava sought and obtained
22 advice that he never obtained.

23 On the funding gap side, I think the answer is
24 that he had a unique role and responsibility as the
25 underwriter. And when you look at the opinion letters

1 that the attorneys provided, it's very clear that they
2 were not giving Mr. Cannava any advice or any cover
3 when it came to any disclosure related to 38 Studios'
4 financial condition.

5 Are there any other questions I can answer for
6 your Honor? I think, then, in closing I'd just say
7 that it's my view that, particularly in light of the
8 summary judgment standard, the SEC has provided
9 significant evidence both of Mr. Cannava's culpable
10 state of mind and of the materiality of these
11 representations and would request summary judgment be
12 denied.

13 THE COURT: Some crazy judge may have called it
14 a Draconian standard, Draconian measure. I don't know
15 who that might have been. Thanks, Ms. Shields, as
16 always.

17 MR. KELLY: Your Honor, if I may briefly
18 respond.

19 THE COURT: Sure.

20 MR. KELLY: And if we could begin where the --

21 THE COURT: You have to wait until you get to
22 the mike.

23 MR. KELLY: Sorry. If we could begin, please,
24 where the SEC began with that e-mail from Mr. Cannava,
25 if we could bring that back up, because I think once

1 again the SEC doesn't -- either doesn't get the point
2 or is deliberately obfuscating the point to the Court.

3 This is Mr. Cannava's e-mail where he's talking
4 about the fees, the \$50,000 worth of fees that they got
5 from 38 Studios on the bond transaction.

6 So it's important for two reasons. Number one,
7 it shows he's the guy who raises his hand and tells his
8 own compliance team, you know, check this out, make
9 sure it's disclosed properly, and then they disclose
10 it.

11 So it's important to show he's not a reckless
12 actor; but it's also important to show it's accurate
13 when he thinks something relates to the bond deal, he
14 discloses it. He didn't think the \$400,000 on the
15 equity engagement, whether it was the so-called side
16 agreement, was related to the bond deal because if he
17 did, he would have disclosed that, too.

18 What does he care? If he's disclosing the dual
19 master of the 50,000, why not throw in another 400 if
20 he thought it pertained to the bond deal? He didn't.
21 He thought it pertained to the equity deal, a separate
22 deal, much like the head of the public finance at Wells
23 Fargo who was, in fact, a senior banker; who was, in
24 fact, a little bit more than 30 years old; who did, in
25 fact, testify under oath that he didn't think it had to

1 be disclosed, it was part of the equity equation, not
2 the bond equation, because when Cannava heard about the
3 50,000 coming from 38 Studios rather than EDC, he made
4 sure it was disclosed.

5 And he didn't know about the other 400,000; but
6 if he had, he would have disclosed that, too, as
7 evidenced by this. So that's with the so-called side
8 agreement, the equity deal.

9 Now, I want to get back to -- and perhaps, you
10 know, I know there's been a lot of filings in this
11 case. Perhaps the Court wants me to file something
12 additional, but I have several cites I'd like to give
13 the Court on the expert opinion issue.

14 There's a First Circuit case called *Geffon v.*
15 *Micrion* at 249 F.3d 29 which holds that the expert
16 opinion about correct industry terms shows at best that
17 a Defendant should have known a statement was
18 misleading which is, at best, negligence, not
19 recklessness. So that's one case we have.

20 We have another case, which is the *Town of*
21 *Winchester* case, that's a District Court opinion out of
22 Mass., 707 F.Supp. 611, pinpoint cite 619 to 20, where
23 it says, The mere statement of the expert, however,
24 that in his opinion the facts do or do not meet this
25 particular legal standard does not create a genuine

1 issue of material fact.

2 Otherwise, in every case someone would just hire
3 an expert to say, no, in my opinion it's a material
4 fact in dispute here and, therefore, let's have a
5 trial. So that's --

6 THE COURT: Rather cynical about expert
7 witnesses there, Mr. Kelly.

8 MR. KELLY: But I think on the money. That's
9 what often happens. So I would bring those two cases
10 to the Court's attention. I would note *Flannery*.

11 Look, *Flannery* itself said that when there's no
12 actual investor who found an omission material, like in
13 this case, a Defendant can't ignore an obvious danger
14 of misleading investors when no investor was misled,
15 which is what happened in this case.

16 They have zero investors who were misled. They
17 have -- you know, they're tilting at windmills here to
18 pretend they're protecting the investing public.

19 What's really going on here is, a couple of
20 years ago there was a DOJ policy where you had to throw
21 an individual in whenever you charged a company. I
22 think it was called the Yates memo or something to that
23 effect, and that's how Cannava gets dragged in.

24 The SEC wants an individual scalp, and it's not
25 fair. It's not appropriate. He should not be pushed

1 into a trial where he has to endure another six or
2 whatever months it is of this stress, this tarnishing
3 of his reputation.

4 He did not act recklessly. That's the bottom
5 line. They have no evidence of recklessness. And
6 since they have no evidence, it's their burden to show
7 that now it's under the case law put up or shut up
8 time, they haven't put up.

9 Zero evidence means summary judgment on both
10 allegations, your Honor. And, again, if the Court
11 wants us to submit something on that expert point, I'd
12 be happy to do so.

13 THE COURT: Thanks, Mr. Kelly.

14 I'm going to give you my opinion. Before I do,
15 let me once again underscore the incredible admiration
16 I have for the lawyering that went on in this case. I
17 am very proud to have people represent an individual as
18 well as Nixon Peabody and team have Mr. Cannava, and I
19 am incredibly proud of the Government's attorneys that
20 represent me and everyone else in this country in their
21 endeavors to follow their mission.

22 It is clear to the Court that the SEC has failed
23 to provide evidence upon which a reasonable jury could
24 determine that Mr. Cannava acted with the necessary
25 scienter, that is, that he acted knowingly or

1 recklessly.

2 There is simply insufficient evidence upon which
3 a jury could determine that Mr. Cannava knowingly
4 misled investors or recklessly disregarded the dangers
5 of misleading investors.

6 Congress has determined that to hold the
7 individual liable, the SEC must go beyond negligent
8 acts. The First Circuit has defined this heightened
9 standard by stating in the *Fyfe* case that the conduct
10 must consist of a highly unreasonable omission,
11 involuntarily not -- I can't read my own handwriting,
12 not merely simple or even inexcusable negligence but an
13 extreme departure from the standards of ordinary care
14 and which presents a danger of misleading buyers or
15 sellers that is either known to the Defendant or is so
16 obvious that the actor must have been aware.

17 The two areas where the SEC accuses Mr. Cannava
18 of knowingly or reckless actions are the funding gap
19 and the failure to disclose the side agreement. These
20 omissions were not, in this Court's finding, highly
21 unreasonable.

22 There's simply no evidence that Mr. Cannava
23 acted in bad faith or had knowledge of any wrongdoing.
24 In fact, the evidence seems to this Court to point to
25 the fact that Mr. Cannava, rather than acting

1 recklessly, actually engaged in a good faith,
2 professional analysis and review in preparing the PPM
3 and he rightly sought and relied upon professionals of
4 all areas of expertise, all of whom signed off on his
5 work.

6 All the evidence points to the fact that the
7 backing of the state of -- excuse me. In light of this
8 conclusion, the Court does not need to address the
9 issue of whether the omissions were material, but the
10 Court does find that there is likely insufficient
11 evidence of either of the omissions being material.

12 First, all of the evidence points to the fact
13 that the backing of the State of Rhode Island and the
14 insurance were the key financial factors involved in
15 the investors' decision or a reasonable investor's
16 decision to invest or not to invest.

17 Secondly, all investors say that they were not
18 misled and suffered no adverse consequences, determined
19 that 38 Studios financial status was not relevant to
20 them and, most importantly, not a single one of them
21 would have made a different decision if the omitted
22 information were known.

23 The only ones duped here were the Rhode Island
24 taxpayers, not the bondholders. They had Rhode Island
25 backing them.

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The Court grants Mr. Cannava's motion for summary judgment, and judgment will enter for him.

MR. KELLY: Thank you, your Honor.
(Adjourned)

* * * * *

C E R T I F I C A T I O N

I, Karen M. Wischnowsky, RPR-RMR-CRR, do hereby certify that the foregoing pages are a true and accurate transcription of my stenographic notes in the above-entitled case.

June 12, 2019

Date

/s/ Karen M. Wischnowsky

Karen M. Wischnowsky, RPR-RMR-CRR
Federal Official Court Reporter