UNITED STATES DISTRICT COURT

DISTRICT OF MAINE

GOODWIN PROPERTIES, LLC, et al.,	***)***	
	)	
Plaintiffs	***)***	
	)	
v.	***)***	***Docket No. 01-49-P-C***
	)	
ACADIA GROUP, INC., et al.,	***)***	
	)	
Defendants	***)***	

RECOMMENDED DECISION ON MOTIONS TO DISMISS

The defendants, Acadia Group, Inc. ("Acadia"), Advest, Inc. ("Advest"), Billings & Co., Inc. ("Billings"), Emile L. Clavet and Kevin B. Dean, move to dismiss the complaint in this action arising out of the sale of unregistered securities. There are two motions, one brought by Advest and Billings and the other by the remaining defendants. They raise essentially the same issues. I recommend that both motions be granted.

I. Applicable Legal Standard

The motions invoke Fed. R. Civ. P. 9(b) and 12(b)(6). "When evaluating a motion to dismiss under Rule 12(b)(6), [the court] take[s] the well-pleaded facts as they appear in the complaint, extending the plaintiff every reasonable inference in [its] favor." *Pihl v. Massachusetts Dep't of Educ.*, 9 F.3d 184, 187 (1st Cir. 1993). The defendant is entitled to dismissal for failure to state a claim "only if it clearly appears, according to the facts alleged, that the plaintiff cannot recover on any viable theory." *Correa-Martinez v. Arrillaga-Belendez*, 903 F.2d 49, 52 (1st Cir. 1990); *see also Jackson v. Faber*, 834 F. Supp. 471, 473 (D. Me. 1993). The parties disagree on the question whether the claims raised in the complaint are subject to the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. 104-67, 109 Stat. 737. If the PSLRA applies, additional pleading requirements must be met. These requirements will be discussed in Section X of this recommended decision.

Fed. R. Civ. P. 9(b) provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." A complaint alleging fraud in connection with a transaction in securities must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Suna v. Bailey Corp.*, 107 F.3d 64, 68 (1st Cir. 1997) (quoting *Shields v. Citytrust Bancorp., Inc.*, 25 F.3d 1124, 1127-28 (2d Cir. 1994)). A securities plaintiff "must allege specific facts that make it reasonable to believe that defendant[s] knew that a statement was materially false or misleading." *Id*. (internal quotation marks omitted; brackets in original). Statements made on information and belief do not meet the particularity requirement of Rule 9(b) unless the complaint also pleads facts on which the belief is founded. *In re One Bancorp Sec. Litig*., 135 F.R.D. 9, 12-13 (D. Me. 1991). Further refinements of this standard by the First Circuit will be discussed in Section X of this recommended decision.

II. Factual Background

The complaint includes the following relevant factual allegations. Plaintiff Goodwin Properties, LLC is a New Hampshire limited liability company. Complaint (Docket No. 1) ¶ 8. Plaintiff John Goodwin is the trustee of the Goodwin Revocable Trust, a Florida trust with an address in New Hampshire. *Id*. ¶ 9. Plaintiffs Harold and Lois Marden are residents of Maine. *Id*. ¶¶ 10-11. Lois Marden asserts claims on her own behalf and on behalf of her two minor children. *Id*. ¶¶ 12-13. Acadia is a publicly held Colorado corporation with a principal place of business in Auburn, Maine.

Id. ¶ 14. Advest is a Delaware corporation with a place of business in Lewiston, Maine. *Id*. ¶ 15. Billings is a Connecticut corporation with its principal place of business in Hartford, Connecticut. *Id.* ¶ 16. Emile L. Clavet is a resident of Auburn, Maine and chairman of the board of Acadia. *Id*. ¶ 17. Kevin B. Dean is a resident of Auburn, Maine and executive vice president and a director of Acadia. *Id*. ¶ 18. He served as treasurer of Acadia from approximately November 22, 1999 through March 9, 2000. *Id.*

Prior to November 19, 1999 Acadia National Health Systems, Inc. ("ANHSI"), a publicly held corporation, provided business management services to physicians and hospitals. *Id*. ¶ 19. As of September 30, 1999 ANHSI had issued and outstanding 5,013,987 shares of common stock. *Id*. ¶ 20. Prior to November 19, 1999 ANHSI formed WorldLecture.com, Inc. for the purpose of acquiring MedLecture.com, Inc. by merger and also formed Acadia Merger Holding Company for the purpose of acquiring substantially all of the assets of ANHSI, subject to liabilities. *Id*. ¶ 21. On November 19, 1999 MedLecture.com, Inc., which sold continuing education services via the Internet, was merged into WorldLecture.com, Inc. and ANHSI issued 5,363,897 shares of its common stock in consideration for the purchase of the outstanding shares of MedLecture.com, Inc. *Id*. ¶¶ 22-23. At the same time, Acadia was created as a post-merger holding company with ANHSI as a subsidiary. *Id*. ¶ 24.

After November 19, 1999 Acadia described its mission as a venture capital incubator corporation providing management and financial services to entrepreneurs; it intended to acquire ownership positions in the entrepreneurial ventures in which it participated. *Id*. ¶ 26. On and after this date Clavet and Dean became the controlling persons of Acadia by reason of their aggregate ownership of 20.8% of its issued and outstanding voting stock, their respective positions as Acadia's chairman of the board and treasurer, and their actual direction of Acadia's day-to-day business affairs. *Id*. ¶ 30. Acadia had no prior history as a venture capital incubator corporation. *Id*. ¶ 31.

On or about April 30, 1999 ANHSI obtained loans from Citizens Bank of New Hampshire to finance the operation of its medical management services business. *Id*. ¶ 32. The bank provided a line of credit up to $1,250,000 and a term loan of $250,000. *Id*. On September 30, 1999 ANHSI owed $1,043,154 on the line of credit and $243,006 on the term loan. *Id*. ¶ 33. On or about November 19, 1999 Acadia contacted the bank, which gave conditional consent to the reorganization and restructuring and waived default on the loan agreements. *Id*. ¶ 35. At that time, the bank informed Acadia that it would not continue the lending relationship beyond April 30, 2000. *Id*. ¶ 36. On December 30, 1999 the bank restructured the lending relationship to include Acadia and its subsidiaries as borrowers. *Id*. ¶ 37.

On or about November 22, 1999 the board of directors of Acadia voted to authorize the sale of not less than 1,052,632 and not more than 2,105,263 shares of its common stock at the price of $4.75 per share in a private offering as defined by section 4(2) of the Securities Act of 1933, 15 U.S.C. § 77(2). *Id*. ¶ 39. The shares were not registered with the Securities and Exchange Commission or the Maine Securities Administrator. *Id*. ¶ 40. Acadia has at all relevant times claimed that the offering was exempt from the registration requirements of the Securities Act and the Revised Maine Securities Act and complied with Regulation D, 17 C.F.R. §§ 230.501-230.505. *Id*. Acadia employed Advest to act as investment banker and place the shares with investors. *Id*. ¶ 41. Acadia also employed Billings, Advest's sister corporation, to participate in the solicitation of investors as a subcontractor to Advest. *Id*. ¶ 42.

On or about February 8, 2000 Acadia published a confidential private offering memorandum ("CPOM") offering the shares for a total price of $10,000,000. *Id*. ¶ 43. Over a period of weeks prior to February 10, 2000 representatives of Advest solicited Goodwin to subscribe for shares to be offered by Acadia. *Id*. ¶ 45. On or about February 10, 2000 Goodwin received the CPOM and a supplementary form from Advest. *Id*. ¶ 46. On or about February 21, 2000 Goodwin executed and delivered to Advest a subscription agreement and related documents to purchase 63,000 shares of the Acadia common stock on behalf of Goodwin Properties, LLC. *Id*. ¶ 47. Also on that date, Goodwin executed and delivered to Advest a subscription agreement and related documents to purchase 10,000 shares of the stock on behalf of the John Goodwin Revocable Trust. *Id*. ¶ 48. In both cases, the entire subscription price was paid to First Union Trust as escrow agent to be held in escrow pending satisfaction of the conditions described in the escrow agreement attached as Exhibit A to the CPOM. *Id*. ¶¶ 47-48. After March 7, 2000 Goodwin received a first supplement to the CPOM which included a copy of Acadia's quarterly report (Form 10QSB) for the period ended December 31, 1999. *Id.* ¶ 49.

Over a period of weeks prior to February 10, 2000 authorized representatives of Advest solicited Harold Marden to subscribe for the shares to be offered by Acadia. *Id*. ¶ 50. On or about February 10, 2000 Harold Marden received the CPOM and a supplementary form. *Id*. ¶ 51. On a date in February 2000 Harold and Lois Marden executed and delivered to Advest a subscription agreement to purchase 21,053 shares of the Acadia common stock and subscription agreements to purchase 2,105 shares of the Acadia common stock on behalf of each of their minor children. *Id*. ¶¶ 52-53. The entire subscription price for each purchase was paid to the escrow agent. *Id*. Harold Marden received a copy of the first supplement to the CPOM after March 7, 2000. *Id*. ¶ 54.

The subscription agreements were irrevocable and performance was subject only to the determination by Acadia that the terms of the offering had been met. *Id*. ¶ 57.

On or about March 17, 2000 Goodwin and Harold Marden both received a second supplement to the CPOM which included an amended current report (Form 8-K/A) presenting audited financial statements for MedLecture.com, Inc. for the nine month period ending September 30, 1999 and unaudited combined financial statements of MedLecture.com, Inc. and ANHSI for the twelve month period ending September 30, 1999. *Id*. ¶ 58. On or about April 21, 2000 Goodwin and Harold Marden each received a third supplement to the CPOM. *Id*. ¶ 60.

On January 18, 2000 Acadia borrowed $450,000 from Clavet and Dean and $50,000 from another director of Acadia, agreeing to repay the loans with proceeds from the offering. *Id*. ¶ 59. The loans were repaid with interest and fees from the proceeds of the offering on May 4, 2000. *Id*. On February 25, 2000 Acadia borrowed $200,000 from Clavet and Dean, and on March 17, 2000 another $50,000, all to be repaid from the proceeds of the offering. *Id*. These loans were converted into shares of Acadia's common stock on April 26, 2000, based on a payment obligation of $305,000 and a conversion price of $4.75 per share. *Id*.

On April 26, 2000 Acadia deemed the conditions of the offering satisfied and accepted subscriptions from investors for 1,059,073 shares of its common stock and for total gross proceeds of $5,030,596.75 less related fees, expenses and commissions. *Id*. ¶ 61. The proceeds included $3,585,000 in investments and retirement of debt and other obligations in the amount of $1,450,000. *Id*. On April 30, 2000 Acadia's line of credit expired and Citizens Bank of New Hampshire demanded payment for all amounts due on the line of credit and the term loan. *Id*. ¶ 62. On or about June 1, 2000 the bank made a formal demand for payment and Acadia formally defaulted. *Id*. ¶ 63. On or about July 7, 2000 the bank began legal action for collection and attached certain assets of Acadia and its subsidiaries. *Id*.

The market value of Acadia's common stock began a steep decline on or about April 30, 2000. *Id*. ¶ 65. The shares purchased by the plaintiffs have been valueless since approximately July 7, 2000. *Id*. On or about September 28, 2000 the directors of Acadia voted to cease operations. *Id*. ¶ 64.

III. Discussion

The complaint alleges violation of 15 U.S.C. § 77e(a), 15 U.S.C. § 77e(b)(2), 17 U.S.C. § 77*l*(2), 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5, and 32 M.R.S.A. §§ 10201 and 10401, as well as common law counts of fraud, negligent misrepresentation and breach of contract. The defendants contend that the documents involved in the offering establish that it was a private offering exempt from the statutory requirements on which the plaintiffs rely, that the complaint fails to meet applicable pleading requirements and that the court should decline to exercise jurisdiction over the state-law claims, if those claims are not subject to dismissal themselves. Portions of the documents at issue have been attached to and included by reference in the complaint. Complaint ¶¶ 43, 46, 49, 55, 58, 60 & Exhs. A-F. The defendants have provided the remaining portions of those documents. "In deciding a motion to dismiss a securities action, a court may properly consider the relevant entirety of a document integral to or explicitly relied upon in the complaint, even though not attached to the complaint, without converting the motion into one for summary judgment." *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1220 (1st Cir. 1996).

A. The Claims Under 15 U.S.C. §§ 77e & 77*l*

Count I of the complaint alleges violation of 15 U.S.C. § 77e(a), also known as section 12(1) of the Securities Act. Count III invokes 15 U.S.C. § 77e(b)(2). Count IV is based on 15 U.S.C. § 77*l*(a) (2), also known as section 12(2) of the Securities Act. The defendants' claim that the offering in which the plaintiffs participated was a private offering under the Securities Act, exempting it from the requirements of these statutes, applies equally to all three counts. 15 U.S.C. § 77d(2) ("The provisions of section 77e of this title shall not apply to . . . transactions by an issuer not involving any public offering."). This statutory section is also known as section 4(2) of the Securities Act.

The sections of the Securities Act on which the plaintiffs rely provide as follows:

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly —
>
> **(1)** to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> **(2)** to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

15 U.S.C. § 77e(a).

> It shall be unlawful for any person, directly or indirectly —
>
> * * *
>
> **(2)** to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

15 U.S.C. § 77e(b)(2).

> Any person who —
>
> * * *
>
> **(2)** offers or sells a security . . . , by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable . . . to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77*l*(a)(2). There is no dispute that the stock purchased by the plaintiffs was a security within the definition provided by the Securities Act. 15 U.S.C. § 77b(a)(1).

The regulations that implement 15 U.S.C. § 77d(2) are found at 17 C.F.R. §§ 230.501-230.508, commonly referred to as Regulation D. The defendants contend that the offering to which the plaintiffs responded by making the purchases at issue fell within the requirements of those regulations and that this fact is apparent from the face of the complaint and the incorporated documents. Motion to Dismiss of Defendants Advest, Inc. and Billings & Co., Inc., etc. ("Advest Motion") (Docket No. 5) at 8-14; Motion to Dismiss of Acadia Group, Inc., Emile L. Clavet and Kevin B. Dean, etc. ("Acadia Motion") (Docket No. 10) at 10. The plaintiffs respond that this question cannot be resolved in the context of a motion to dismiss, Plaintiffs' Objection to Motions to Dismiss by All Defendants, etc. ("Plaintiffs' Objection") (Docket No. 12) at 7,[1] and that two reasons why the offering did not meet the regulatory requirements are apparent on the face of the complaint, *id*. at 10.

The plaintiffs' first argument is incorrect. In *Maldonado v. Dominguez*, 137 F.3d 1, 8 (1st Cir. 1998), the First Circuit specifically found that the pleadings in that case established that the placement at issue was a private placement and affirmed the district court's grant of the defendants' motion to dismiss. In *Fisk v. SuperAnnuities, Inc.*, 927 F. Supp. 718 (S.D. N.Y. 1996), the only case cited by the plaintiffs on this point that actually addresses Regulation D, the district court held that the private placement documents would not be sufficient to support dismissal of the plaintiff's claim based on an allegation that the offering was not in fact a private one when there was evidence supporting the plaintiff's suggestion that the offering was not limited to the appropriate type of investors. *Id*. at 730-31. The plaintiffs' allegations in the complaint in this action concerning the facts that they believe take the offering at issue outside Regulation D are not sufficiently similar to those made in *Fisk*, and, in any event, even if this court were not constrained to follow First Circuit law, I find the language of the *Fisk* court to be unduly expansive on this point, particularly in the light of the

[1] The plaintiffs contend that "[t]he Defendants do not come close to meeting their burden of proof." Plaintiffs' Objection at 7. This is not an accurate statement of the legal standard applicable to a motion to dismiss, which was set out in section I of this recommended decision.

pleading requirements imposed by the PSLRA, which will be discussed later in this recommended decision.

The plaintiffs offer two duly pleaded reasons why the offering at issue may not be considered private and accordingly exempt from the statutory or regulatory requirements that provide the basis for their claims in Counts I, III and IV at this stage of the proceedings: (i) they were not duly accredited investors as defined by 17 U.S.C. §77b(a)(15) and the CPOM issued in connection with the subject offering and as required by 17 C.F.R. § 230.506; and (ii) the corporate reorganization that preceded the offering was "a scheme intended to evade the [corporate security] registration requirements," an apparent reference to Preliminary Note 6 to Regulation D.[2] Plaintiffs' Objection at 10; Complaint ¶¶ 68-71.

Section 506 of Regulation D provides an exemption from registration requirements for offers and sales of securities that satisfy all of the terms and conditions of sections 501 and 502, when there are no more or the issuer reasonably believes that there are no more than 35 purchasers of the offering and when each person who is not an accredited investor has such knowledge and experience in financial and business matters that he is capable of evaluating the risks and merits of the proposed investment, or the issuer reasonably believes that the purchaser comes within this description. The plaintiffs' argument is based solely on their contention that they are not accredited investors and did not have such knowledge and experience. Plaintiffs' Objection at 10-12. For the purposes of section 506, an "accredited investor" is defined as follows, in relevant part:

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[2] The note provides:

> In view of the objectives of these rules and the policies underlying the Act, regulation D is not available to any issuer for any transaction or chain of transactions that, although in technical compliance with these rules, is part of a plan or scheme to evade the registration provisions of the Act. In such cases, registration under the Act is required.

Preliminary Note 6 to Regulation D — Rules Governing the Limited Offer and Sale of Securities Without Registration under the Securities Act of 1933, immediately preceding 17 C.F.R. § 230.501.

> *Accredited investor*. *Accredited investor* shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:
>
> * * *
>
> (3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;
>
> * * *
>
> (5) Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000;
>
> (6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching that same income level in the current year;
>
> (7) Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in § 230.506(b)(2)(ii) . . . .

17 C.F.R. § 230.501(a).

The plaintiffs make no attempt to show how or why the definition of "accredited investor" at 15 U.S.C. § 77b(a)(15), which is limited to the term's use "in this subchapter" of the statute, applies to the offering at issue, which was purportedly made under 15 U.S.C. § 77d(2), which does not use the term. In any event, the statutory definition specifically includes "any person who . . . qualifies as an accredited investor under rules and regulations which the Commission shall prescribe," 15 U.S.C. § 77b(a)(15)(ii), and thus includes the definition provided by 17 C.F.R. § 230.501(a) quoted above.

The defendants argue that the plaintiffs represented in writing at the time of the sale that they were accredited investors and may not now rely on the allegations in their complaint that they were not. Advest Motion at 8-10; Acadia Motion at 11. The plaintiffs respond that their allegations in paragraphs 71(a) and 72 of the complaint are sufficient to avoid dismissal and that the defendants' argument relies on the doctrine of equitable estoppel, which is not applicable under the circumstances. Plaintiffs' Objection at 10-12. Paragraph 71(a) of the complaint alleges that the plaintiffs were not accredited investors because "the issuer had no reason to believe that purchasers had such knowledge and experience in financial and business matters that they were capable of evaluating the merits and risks of the investment" and because the issuer "failed to provide the information required by 17 C.F.R. § 230.502(b)(2)." Complaint ¶ 71(a). Paragraph 72 merely recites that the plaintiffs were in fact unable to recognize "the nature of the issuer's business, the financial position of the issuer and the risks of loss of the investment" due to the alleged failure to provide required information or to sell registered securities. *Id*. ¶ 72.

First, the applicable regulatory definition of an "accredited investor" does not require that the issuer have reason to believe that the purchaser had certain knowledge and experience. Indeed, the formulation upon which the plaintiff relies applies only when the investor is *not* accredited. 17 C.F.R. § 230.506(b)(2)(ii). The plaintiffs themselves provided the defendants with reason to believe that they were accredited investors as defined by 17 C.F.R. § 230.501(a). Confidential Private Offering Memorandum (Exh. A to Advest's Motion) at 6 & Exh. A (Form of Escrow Agreement) at 1; Goodwin Properties L.L.C. Subscription Agreement (Exh. E to Advest's Motion) §§ 4(c), 5.1 & Schedules A & B thereto; [Marden] Subscription Agreement (Exh. F to Advest's Motion) §§ 4(c), 5.1 & Schedules A & B thereto. They cannot now disavow those representations in order to support their claims against the defendants. *Wright v. National Warranty Co.*, 953 F.2d 256, 260 (6th Cir. 1992) (summary judgment); *Noz v. Value Investing Partners, Inc.*, 1999 WL 387400 (S.D. N.Y. June 14, 1999) at *1 (motion to dismiss).[3] The complaint and the documents from which the plaintiffs' claims arise establish that the offering at issue did not lose its "private" status under Regulation D due to the status of the plaintiffs as other than accredited investors. Contrary to the plaintiffs' argument, this

[3] The plaintiffs assert in conclusory fashion that "[n]one of these cases are relevant to the issue at hand," Plaintiffs' Objection at 11 & n.4, but provide no reasons why this asserted distinction exists. After a review of the cited opinions, no basis for such a distinction is apparent to me.

analysis of the relevant documents does not depend on or require application of the doctrine of equitable estoppel.

Nor does the allegation that the defendants failed to comply with 17 C.F.R. § 230.502(b)(2) help the plaintiffs avoid dismissal. Contrary to the necessary implication of the allegation in paragraph 71(a) of the complaint, there is no requirement in Regulation D or the relevant statutes that an investor receive certain information from the issuer in order to be considered accredited. In fact, the regulation cited by the plaintiffs itself makes this clear: "If the issuer sells securities under . . . §203.506 to any purchaser *that is not an accredited investor*, the issuer shall furnish the information specified in paragraph (b)(2) of this section to such purchaser a reasonable time prior to sale." 17 C.F.R. § 230.502(b)(1) (emphasis added). Since the plaintiffs may not disavow their representations to the defendants that they were in fact accredited investors, this section of Regulation D does not apply to them.

The plaintiffs' second pleaded reason why the offering at issue was not private and accordingly not exempt from the requirements on which their claims are based — that the reorganization of Acadia in late 1999 represented an attempt to evade the registration requirements that renders Regulation D unavailable for purposes of the 2000 offering — is based on 17 C.F.R. § 230.502(a), Plaintiffs' Objection at 12, which provides:

> All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D. Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D, other than those offers or sales of securities under an employee benefit plan as defined in rule 405 under the Act (17 CFR 230.405).

17 C.F.R. § 230.502(a). No employee benefit plan is involved in this case. The complaint alleges that the reorganization took effect on November 19, 1999 and that the CPOM was issued on February 8, 2000, Complaint ¶¶ 31, 43, fewer than six months later.

The Acadia defendants respond, in conclusory fashion and without citation to authority, that "in this case there was only one" private offering. Reply Memorandum in Support of the Motion to Dismiss of Acadia Group, Inc., Emile L. Clavet and Kevin B. Dean ("Acadia Reply") (Docket No. 13) at 5. That is not the issue with respect to the plaintiffs' claim based on 17 C.F.R. § 230.502(a). The issue is whether the transfer of shares alleged in the complaint to have taken place during the reorganization must be integrated with the private offering at issue and, if so, whether the result of that integration is that exemption from registration pursuant to Regulation D was unavailable for the offering at issue. The complaint alleges that ANHSI issued shares of its common stock on November 19, 1996 in consideration for acquisition of the outstanding shares of MedLecture.com, Inc. Complaint ¶ 22. Such a transfer comes within the definition of sale applicable to section 230.502(a) of the regulations. 15 U.S.C. § 77b(a)(3); *see, e.g.*, *Rathborne v. Rathborne*, 683 F.2d 914, 918 (5th Cir. 1982) (stock-for-assets trade between independent corporations constitutes sale of securities for purposes of section 10(b) of Securities Act). Indeed, the SEC has promulgated regulations applicable to such transactions. 17 C.F.R. §§ 229.1000-229.1006. *See SEC v. Cavanagh*, 1 F.Supp.2d 337, 363-367 (S.D. N.Y. 1998) (finding that unregistered sale of stock and earlier merger effectuated by issuance of stock should be considered integrated, making claimed exemption under 15 U.S.C. § 77d(1) unavailable).

Accompanying section 230.502(a) of the regulations is a list of factors to be applied in determining whether two transactions should be considered integrated:

> The following factors should be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D:
>
> (a) Whether the sales are part of a single plan of financing;
> (b) Whether the sales involve issuance of the same class of securities;
> (c) Whether the sales have been made at or about the same time;
> (d) Whether the same type of consideration is being received; and
> (e) Whether the sales are made for the same general purpose.

17 C.F.R. § 230.502(a) Note. The complaint alleges that stock of ANHSI was the consideration for the acquisition of MedLecture.com, Inc., Complaint ¶ 22, and that the issued stock of Acadia Group, Inc., "the post-merger holding company" of which ANHSI became a subsidiary, provides the basis for the claims in this action, *id*. ¶¶ 24, 39. Assuming *arguendo* that the two types of stock could be "the same class of securities," as required by the second factor, the complaint can be read to allege the first, second and fifth factors as well. *Id*. ¶¶ 22, 39, 69. However, the complaint cannot be read to allege that the same type of consideration was received for the two types of stock, the fourth factor of the regulatory test. The complaint can only be read to allege that stock and assets of MedLecture.com, Inc. were received as consideration for the first sale and cash and loan forgiveness was received for the second sale. Because the complaint fails to allege this element of the test for integration under 17 C.F.R. § 230.520(a), the plaintiffs cannot rely on this section of the regulations to support their allegation that the February 8, 2000 offering was not exempt from registration under Regulation D. *See generally Johnston v. Bumba*, 764 F. Supp. 1263, 1272 (N.D. Ill. 1991) (requiring proof of all five factors).

The plaintiffs identify no other basis for their allegation that the transaction at issue was intended to evade registration requirements. Plaintiffs' Objection at 12-14. Accordingly, the defendants are entitled to dismissal of Count I of the complaint.

Count III of the complaint alleges failure to provide a prospectus in connection with the February 8, 2000 offering as allegedly required by 15 U.S.C. § 77e(b)(2). Complaint ¶¶ 79-82.

However, the exemption provided by 15 U.S.C. § 77d(2) applies to all requirements of 15 U.S.C. § 77e. Accordingly, because the complaint fails to show on its face and in the incorporated documents that the offering at issue was anything other than a private offering exempt under section 77d(2), the defendants are entitled to dismissal of Count III.

Count IV of the complaint alleges fraud in the sale of the subject securities under 17 U.S.C. § 77*l*(2), commonly referred to as section 12(2) of the Securities Act. Complaint ¶¶ 84-87. The defendants contend that section 12(2) only applies to initial public offerings, citing *Gustafson v. Allyod Co.*, 513 U.S. 561, 577, 584 (1995), and *Maldonado*, 137 F.3d at 8-9. The plaintiffs respond that they have alleged that the offering at issue was in fact public, not private, and that such an allegation is sufficient. Plaintiffs' Objection at 17-18. They also argue that *Maldonado* does not apply to the case at hand and that this court has used "[t]he *Maldonado* principle" as "the basis for a more explicit ruling" in *Giarraputo v. Unumprovident Corp*., 2000 WL 1701294 (D. Me. Nov. 8, 2000), and *Andrews v. Emerald Green Pension Fund*, 2000 WL 1473376 (D. Me. Sept. 27, 2000). Plaintiffs' Objection at 18.

In *Gustafson*, the Supreme Court held that liability under section 12 of the Securities Act "is imposed only as to a document soliciting the public," 513 U.S. at 581, 584. The First Circuit in *Maldonado* stated that a claim under section 12(2) may be dismissed if the pleadings establish that the stock at issue was placed privately. 137 F.3d at 8. *See also Vannest v. Sage, Rutty & Co*., 960 F. Supp. 651, 655 (W.D. N.Y. 1997). That is the case here, as discussed above, and the defendants are accordingly entitled to dismissal of Count IV.[4]

[4] Paragraph 28 of this court's opinion in *Andrews*, the only specific citation included in the plaintiffs' reference to it, Plaintiffs' Objection at 18, has no bearing on the issue of the availability of section 12(2) relief. To the extent that the plaintiffs' reference to *Giarraputo*, unaccompanied as it is by a specific citation to any page in that 21-page recommended decision, can be construed to suggest that some support for the plaintiffs' argument may be found therein, I have been unable to locate anything in that recommended decision at all inconsistent with my recommend conclusion on this issue.

B. The Claims Under 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5

In Count V, the complaint alleges that the defendants violated 15 U.S.C. § 78j(b), commonly referred to as section 10b of the Securities Exchange Act, and 17 C.F.R. § 240.10b-5, commonly referred to as Rule 10b-5. Complaint ¶¶ 89-97. In order to state a claim under section 10b and Rule 10b-5, the plaintiffs must show that (i) the defendants made a misrepresentation or omission of material fact, (ii) with scienter, (iii) upon which the plaintiffs relied, and (iv) that caused damage to the plaintiffs. *Shaw*, 82 F.3d at 1217. The defendants argue that the complaint should be dismissed because it fails to meet the pleading requirements of the PSLRA and Fed. R. Civ. P. 9(b) and because it fails adequately to plead scienter and loss causation. Advest Motion at 17-26; Acadia Motion at 13-22.

The plaintiffs begin their opposition to this section of the defendants' motions to dismiss by asserting that the PSLRA does not apply to their complaint because they have not brought a class action. Plaintiffs' Objection at 19. However, the PSLRA by its terms applies to actions other than class actions.[5]

> In *any private action* arising under this chapter in which the plaintiff alleges that the defendant —
>
> **(A)** made an untrue statement of a material fact; or
>
> **(B)** omitted to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

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[5] This fact makes it unnecessary to consider the plaintiffs' curious statement that "Plaintiff [sic] believes the . . . standards [applied by the First Circuit to all actions claiming securities fraud before the enactment of the PSLRA] are excessive in the context of this case." Plaintiffs' Objection at 19.

15 U.S.C. § 78u-4(b)(1) (emphasis added). These pleading requirements apply to this case.

The requirements of the PSLRA for pleading scienter immediately follow the language quoted above.

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, 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). The required state of mind depends on the type of statement allegedly made. If the allegedly false or misleading statement is forward-looking, a plaintiff must be able to prove that the defendant had actual knowledge that the statement was false or misleading when made. 15 U.S.C. § 78u-5(c)(1)(B). A forward-looking statement is defined as

> **(A)** a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial terms;
> **(B)** a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
> **(C)** a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the [SEC];
> **(D)** any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
> **(E)** any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
> **(F)** a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the [SEC].

15 U.S.C. § 78u-5(i)(1). If a statement is not forward-looking, the courts whose decisions are reported differ as to pleading requirements. Some require the plaintiff to plead facts giving rise to a strong inference of recklessness, either by demonstrating that the defendant had the motive and

opportunity to commit fraud or by alleging specific facts constituting circumstantial evidence of conscious behavior or recklessness. *E.g., Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994). Other courts have rejected the "motive and opportunity" alternative, holding that the PSLRA has eliminated it in favor of the more stringent alternative pleading requirement. *E.g., In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 756-57 (N.D. Cal. 1997); *In re Baesa Sec. Litig*., 969 F. Supp. 238, 242 (S.D. N.Y. 1997). In any event, the First Circuit has specifically declined to review or adopt the "motive and opportunity" test set out by the Second Circuit in *Shields*. *Maldonado*, 137 F.3d at 10 n.6 (First Circuit will use its own previously-developed framework for analyzing sufficiency of pleadings in securities cases).

The primary element of a claim under section 10(b) and the accompanying Rule 10b-5 is a showing that the defendant made materially misleading statements or omissions. *Basic Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988). A false statement or omission is considered material if its disclosure would alter the total mix of facts available to an investor and "if there is a substantial likelihood that a reasonable shareholder would consider it important" to the decision to invest. *Id*. at 231. "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Id*. at 239 n.17. Scienter is "a mental state embracing intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

When the allegations in a complaint are based on information and belief, the First Circuit requires that both "the source of the information and the reasons for the belief" be laid out in the complaint. *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991). Not only must the time, place and content of the alleged misrepresentation be alleged, but the complaint must also contain

> factual allegations that would support a reasonable inference that adverse circumstances existed at the time (the statement or representation was made), and were known and deliberately or recklessly disregarded by defendants.

Id. While *Romani* predates the enactment of the PSLRA, the language of that statute is not inconsistent with *Romani*'s requirement that the complaint set forth both the source of the information and the reasons for the belief. The intent of the PSLRA was to make the pleading requirements for private actions alleging securities violations more stringent than those imposed by Fed. R. Civ. P. 9(b). *Powers v. Eichen*, 977 F. Supp. 1031, 1038 (S.D. Cal. 1997).

Rule 9(b) provides as follows:

> In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

The parties agree that the allegations at issue with respect to Count V are set forth in paragraph 86 of the complaint. Advest Motion at 19-20; Acadia Motion at 14-21; Plaintiffs' Objection at 20.

1. Defendants Advest and Billings. Advest and Billings begin with the argument that the complaint fails to allege that Advest and Billings themselves made any of the misrepresentations at issue and that the plaintiffs may not maintain a section 10(b) claim against them merely because they are alleged to have assisted the other defendants in doing so. Advest Motion at 18. The plaintiffs do not respond to this argument. Paragraph 86 of the complaint alleges that all defendants made specified and untrue statements, which appeared in the CPOM or Acadia's Form 10KSB for the period ending September 30, 1999, and that all defendants failed to make certain necessary disclosures. Complaint ¶ 86. There is nothing in the cited Form 10KSB that so much as suggests that Advest and Billings were in any way involved in the preparation or filing of that document, nor does the complaint make any such allegation. Accordingly, Advest and Billings are entitled to dismissal of any claims raised against them in Count V based on subsections (f), (g), and (i) of paragraph 86 of the complaint.

In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the Supreme Court held that section 10(b) does not create liability for those who are alleged to have given aid to a person who commits a manipulative or deceptive act, but only for those who themselves engage in activity prohibited by that section, *id*. at 176-77. However, contrary to the assertions in Advest's motion, the remaining subsections of paragraph 86 of the complaint do not allege that Advest and Billings merely aided the other defendants in the specified violations of section 10(b). Those subsections allege that all of the defendants engaged directly in the violations and, in one instance, Complaint ¶ 86(a), mention Advest and Billings specifically. It is impossible to determine from the CPOM itself that the assertions made therein and alleged in the complaint to be misleading are made only by defendants other than Advest or Billings.

Ordinarily, the plaintiffs' failure to respond to the argument of Advest and Billings on this point would be deemed a waiver of any objection, Local Rule 7(b), and the court could grant the motion even if erroneously based. *See, e.g., Trask v. General Signal Corp*., 1999 WL 1995204 (D. Me. Aug. 13, 1999), at * 3 (Rec. Dec. affirmed Sept. 15, 1999). In this case, I choose to rest my conclusion that Advest and Billings are entitled to dismissal of Count V to the extent that it is based on allegations other than those included in paragraph 86 (f), (g) and (i) of the complaint on their alternative arguments, to which the plaintiffs did respond, which are discussed below.

2. Information and belief. The defendants point out that all of the allegations in paragraph 86 are made on information and belief, Complaint at 22, and contend that the complaint fails to plead facts that satisfy the *Romani* or PSLRA standards for such claims. Acadia Motion at 14; Advest Motion at 19-20. The plaintiffs do not respond specifically to this argument, perhaps because they contend — erroneously — that the PSLRA pleading standards do not apply to them and the pre-PSLRA pleading standards set forth by the First Circuit in *Romani* and other similar cases "are excessive" and should not apply to them, for reasons that they fail to elucidate. In any event, the plaintiffs do address each subsection of paragraph 86 individually in a manner that could be taken to demonstrate a response to this argument, Plaintiffs' Objection at 20-24, so I will address each subsection separately in this regard.

Paragraph 86(a) alleges that Advest and Acadia at page 3 of the CPOM "stated the standards required for qualification of investors to subscribe for the purchase of Acadia's common stock in the Offering which could be amended only to comply with state or local law," a somewhat opaque summary of an extensive discussion of investor suitability found on page 3 of the CPOM. The paragraph further alleges that "such representation was untrue at and after the time made" and that "neither Acadia, Billings nor the individual Defendants had any intention to abide by such investor standards." While it is not apparent to me how Billings and the individual defendants can be liable for statements alleged in the same paragraph to have been made only by Acadia and Advest, that problem is not addressed by the parties. In response to the defendants' contention that this subparagraph neither states with particularity all facts upon which the plaintiffs' belief is formed, 15 U.S.C. § 78u-4(b)(1), nor lays out the source of the information and the reasons for that belief, *Romani*, 929 F.2d at 878, the plaintiffs cite paragraphs 3-6, 36, 59, 61, 62 and 71 of the complaint and argue that "[t]he circumstances strongly infer [sic] that the Defendants were ready to accept any living person with loose change in his pocket" and that it is the defendants' burden to prove that they consistently applied the accreditation standards set forth in the CPOM. Plaintiffs' Objection at 20. The latter argument is premature; the defendants will have no burden of proof if the allegations in the complaint are inadequate under the PSLRA and First Circuit precedent. With respect to the first argument, the cited paragraphs of the complaint do not provide the information required by the PSLRA or *Romani*.

Accordingly, the defendants are entitled to dismissal of Count V insofar as it is based on paragraph 86(a) of the complaint.

Paragraph 86(b) alleges that all of the defendants made the representation on page 6 of the CPOM "that money received from the Plaintiffs and other Subscribers to the Offering would be released from escrow and paid to Acadia only if 'capital in the amount of at least $4,550,000 million[6] [sic] is immediately available to the [Acadia] from this Offering,'" that this representation was untrue when made, and that Acadia's statement of cash flow for the period ended June 30, 2000 subsequently showed that only $3,284,971 in capital was actually made available to Acadia from the offering. In response the plaintiffs cite paragraphs 3-6, 36, 59, 61, 62, and 86(c) of the complaint and the asserted fact that the offering was closed four days before Acadia's loan commitment expired and argue that "[t]he strong inference is that Acadia/Advest would close with whatever proceeds could be generated in order to keep the business afloat." Plaintiffs' Objection at 21. None of the cited paragraphs of the complaint makes the necessary showing of the source of the alleged information.[7] The defendants are entitled to dismissal of Count V to the extent that it is based on paragraph 86(b).

Paragraph 86(c) alleges that all of the defendants stated on page 12 of the CPOM that the net proceeds of the offering would be used "to further capitalize [Acadia's] two subsidiaries, . . . to repay certain indebtedness and accrued interest on lines of credit, and . . . to meet operating expenses of Acadia," and that this representation was untrue when made because "all or a substantial amount of the Offering proceeds were used to repay debts . . . which were not lines of credit, to pay delinquent accounts payable to vendors, and to cure payment defaults in loans made to Acadia by Citizens." The defendants refer to the statement in the CPOM that reads "Management will have broad discretion in

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[6] The word "million" does not appear in the original. CPOM at 6.

[7] In addition, as the Advest defendants point out, the word "capital" in the CPOM need not be defined solely as "cash," a necessary predicate of the plaintiffs' argument. Advest Motion at 20 n. 17. By the terms of the complaint, the offering generated total gross (*continued on next page*)

how to use the net proceeds of this Offering," Advest Motion at 20, but it is not necessary to consider this statement.[8] Paragraph 86(c) alleges nothing to support its assertion that the quoted statement from page 12 of the CPOM was untrue. Use of the proceeds of the offering to repay debts other than lines of credit, to pay accounts payable and to cure payment defaults on loans is not inconsistent with the statement that the proceeds would be used to repay "certain indebtedness" and "to meet operating expenses." Contrary to what appears to be the underlying premise of the plaintiffs' argument with respect to this subparagraph, Plaintiffs' Objection at 21, the quoted language from page 12 of the CPOM did not require Acadia to use the proceeds of the offering for all of the listed purposes.[9] The defendants are entitled to dismissal of Count V to the extent that it is based on the allegations in paragraph 86(c).

Paragraph 86(d) alleges that the following statement on page 12 of the CPOM was untrue when made by all of the defendants: "The Company believes that its existing sources of cash, together with the net proceeds from this Offering (assuming all Shares are subscribed for), will be sufficient to meet the Company's cash needs for its current business through the second quarter of 2001." It alleges that this statement is untrue because Acadia was unable to pay its bills as they came due "at and after February 8, 2000," when the offering was issued, and because "[t]he entire Offering proceeds were committed or consumed upon availability from escrow on or about May 4, 2000." Complaint ¶ 86(d); Plaintiffs' Objection at 22-23. Neither of these facts makes the quoted statement untrue. The

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proceeds of $5,030,596.75, of which $1,450,000 represented retirement of debt and other obligations. Complaint ¶¶ 59, 61.

[8] If I were to reach this argument, I find persuasive the reasoning of Judge Martin in *Halperin v. eBanker USA.COM, Inc.*, 2001 WL 274120 (S.D. N.Y. March 19, 2001), at *3 (statement that "amounts actually expended for each use are at the discretion of the Board of Directors and may vary significantly depending upon a number of factors" barred section 10b claim that representation that proceeds from sale of stock would be used for working capital when part of proceeds was actually used for allegedly speculative investment).

[9] The plaintiffs' assertion that "[t]he Defendants do not contest the truthfulness of the allegations," Plaintiffs' Objection at 21, displays a fundamental misunderstanding of the issue before the court at this time. The question is not whether the allegations in the complaint are truthful but rather whether those allegations, which are made on information and belief, are supported with sufficiently particular allegations concerning the source of the information and the reasons for the plaintiffs' belief that the allegations are truthful.

complaint alleges that not all of the shares in the offering were sold, Complaint ¶ 61, and neither the fact that Acadia was unable to make current payments on its bills at the time of the offering nor the fact that the funds actually received from the offering were exhausted before the second quarter of 2001 makes the quoted statement untrue. The plaintiffs contend that other paragraphs of the complaint support their allegation that this statement was untrue, specifically paragraphs 3-6, 34-39, 59, 61-62 and 86(e)-(m). Plaintiffs' Objection at 22. The cited paragraphs other than sections of paragraph 86 do not provide the support for this allegation that is required by the PSLRA and the First Circuit. While some of the allegations in later subsections of paragraph 86 might appear to provide some of the necessary support, the nature of the statement at issue is one of belief and it is forward-looking. 15 U.S.C. § 78u-5(i)(1). Accordingly, the complaint must offer allegations that demonstrate that the defendants had actual knowledge that the statement was false when made.[10] 15 U.S.C. § 78u-5(c)(1)(B). For the reasons discussed below in my analysis of the remaining subsections of paragraph 86 of the complaint, the complaint fails to meet this standard. Accordingly, the defendants are entitled to dismissal of Count V insofar as it is based on the allegations in paragraph 86(d).

Paragraph 86(e) alleges that the following representation at page 21 of the CPOM was made by all defendants and was untrue when made: "The Company believes that its existing sources of cash, together with the net proceeds from this Offering (assuming the maximum Shares are subscribed for), will be sufficient to meet the Company's cash needs for its current business." The plaintiffs describe this allegation as "a corollary to the misrepresentation described in ¶ 86(d)." Plaintiffs' Objection at 23. However, this subparagraph provides much more detail in support of its allegations than does paragraph 86(d). The problem is that the only sources cited in support of these factual allegations are Acadia's Form 10QSB for the period ended June 30, 2000 and the opinion of Acadia's auditors "[a]t

[10] The complaint does not allege that the statement at issue was misleading when made, an alternate ground for liability under 15 (*continued on next page*)

June 30, 2000," that "Acadia's ability to continue as a going concern was doubtful." Neither document is provided by the plaintiffs. The auditors' opinion, reached and expressed after the statement at issue was made and after the offering had been closed without selling the maximum number of shares, cannot make the statement untrue nor demonstrate that the defendants knew it to be untrue when made. The Form 10QSB could only have been completed after the fact as well and cannot serve to prove actual knowledge on the part of any of the defendants that the forward-looking statement at issue was false when made on February 8, 2000. *See generally Serabian v. Amoskeag Bank Shares, Inc.*, 24 F.3d 357, 367 (1st Cir. 1994) ("[P]laintiffs 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."). Accordingly, the defendants are entitled to dismissal of Count V insofar as it relies on paragraph 86(e).

Paragraph 86(f) alleges that the representation made at pages 16-17 of the Form 10KSB for the year ended September 30, 1999, which is Appendix Document 1 attached to the CPOM, to the effect that the accounts receivable balance of ANHSI was $1,052,415 and its net worth was $461,568 was untrue because the accounts receivable balance was overstated by approximately $490,000; ANHSI was insolvent as of September 30, 1999 because its liabilities exceeded its assets; and Acadia was insolvent as of November 19, 1999 for the same reason. The only support offered for these assertions by the plaintiffs is an "extensive financial analysis of Acadia made by its bank on June 23, 2000," Plaintiff's Objection at 23, which is not cited in the complaint. The plaintiffs seek leave to amend the complaint to incorporate this document, *id*., but such an amendment would be futile. The document, a copy of which is attached to the plaintiffs' objection although the plaintiffs do not cite to any specific section or statement within the document, does not appear to include evidence that could reasonably

U.S.C. § 78u-5(c)(1)(B).

give rise to an inference that any of the defendants knew as of February 8, 2000 that the amount of accounts receivable and net worth of ANHSI stated in the Form 10KSB, which includes an independent auditors' report supporting the financial statements at issue, Acadia Group Inc. Filing Type: 10KSB (Period End: Sep 30, 1999), attached to COPM, at 15-28, were false. The defendants are entitled to dismissal of Count V to the extent that it is based on paragraph 86(f).

Paragraph 86(g) and the remaining subsections of that paragraph allege omissions rather than false or misleading statements. As noted previously, an omission is not actionable absent a duty to disclose. The Advest defendants point out correctly that the complaint fails to allege that the defendants had a duty to disclose the omissions alleged in subsections (g) through (m) of paragraph 86. Advest Motion at 23. The plaintiffs respond that "there was a duty to disclose these material omissions." Plaintiffs' Objection at 24. To the extent that the general rules applicable to motions to dismiss continue to apply in the context of a securities action, the plaintiffs are entitled to a reasonable inference to be drawn from the well-pleaded allegations in these subsections that such a duty existed. That inference alone will not save the remaining claims in paragraph 86, however.

In paragraph 86(g) the plaintiffs allege both that a statement at pages 23-24 of the same Form 10KSB concerning an outstanding note payable to Citizens Bank was untrue at the time it was made and that the bank's alleged November 19, 1999 demand for payment of the note in full by April 30, 2000 should have been disclosed. The only fact offered in paragraph 86(g) in support of the allegation that the statement was untrue is an assertion that the Form 10KSB said that the note was payable in monthly installments through June 4, 2000 but that the bank had made the alleged demand in November 1999 that it be paid in full by April 30, 2000, some 34 days earlier. However, the paragraph of the complaint alleging that the bank did in fact inform "Acadia senior management" on or about November 19, 1999 "and in subsequent conversations" that it would not continue its lending relationship with

Acadia beyond April 30, 2000, Complaint ¶ 36, fails to state the source of this information, as required by *Romani*. Accordingly, the complaint does not support the allegation that the statement at issue was untrue when made. With respect to the claim that the defendants had a duty to disclose the alleged decision by the bank, something more than a conclusory statement that such a duty existed is required. A duty to disclose "may arise if, *inter alia*, a corporation has previously made a statement of material fact that is either false, inaccurate, incomplete, or misleading in light of the undisclosed information." *Gross v. Summa Four, Inc.*, 93 F.3d 987, 992 (1st Cir. 1996). Of course, "a corporation does not commit securities fraud merely by failing to disclose all nonpublic material information in its possession." *Id*. Here, while the alleged fact that the outstanding principal amount of $243,006 was payable on April 30, 2000 may have made the representation that the note was payable on June 4, 2000 inaccurate or incomplete, the plaintiffs have made no attempt to show that this information would be material. Under the circumstances, including the financial statements supplied with the CPOM showing accounts receivable in an amount that exceeded the value of the loan by a factor of five and the fact that the offering sought to raise between $5,000,00 and $10,000,000, I can only conclude that the failure to mention that the loan was payable in full five weeks earlier did not alter the total mix of facts available to an investor nor was there a substantial likelihood that a reasonable shareholder would consider it important, *Basic*, 485 U.S. at 231, thereby rendering the alleged omission immaterial and not actionable. The defendants are entitled to dismissal of Count V to the extent that it is based on paragraph 86(g).

In paragraph 86(h) the complaint alleges that the CPOM and its attachments omit the material fact that the Citizens loan was in default "at and after February 8, 2000," the date of the offering. The complaint fails to provide the source of this information and this paragraph fails for that reason alone. In addition, paragraph 86(h) does not provide sufficient information to allow the reader to draw the inference that this information was material. The defendants are entitled to dismissal of Count V to the extent that it is based on paragraph 86(h).

Paragraph 86(i) alleges that footnote 6 on pages 23-24 of the September 30, 1999 Form 10KSB failed to disclose the allegedly material facts discussed in connection with subsections (g) and (h) above and the allegedly material fact that the Citizens loan "was in default of borrowing limitations insofar as the line had been overdrawn." Paragraph 86(i) fails to meet the PSLRA and First Circuit pleading requirements for the reasons stated in connection with paragraph 86(g) and (h) above. The allegation of the existence of a default fails for the same reasons.

Paragraph 86(j) alleges that the CPOM and unidentified "related documents" omit the material fact that "at and after February 8, 2000, Acadia and/or Acadia National Health Systems, Inc., were in default of lease obligations for non payment of rent in a material amount . . . and demand had been made by the lessor for payment." In the absence of any allegation of the "material amount" at issue and any identification of the lease obligations, this subparagraph fails to meet the particularity requirements of the PSLRA. In addition, the complaint fails to identify which representations in which documents made by which defendants were rendered false, inaccurate, incomplete or misleading by the omission of this information.

Paragraph 86(k) alleges that the defendants failed to disclose in the CPOM or any of its attachments or supplements that Acadia "had undertaken a capital investment and business development effort commencing on or about November 16, 1999, that consumed capital beyond the resources of Acadia and increased operating expenses by approximately 267%." The plaintiffs do not identify any reference in the complaint to the source of this information or the basis for their belief that this statement is accurate, and this allegation is accordingly insufficient. The paragraph also alleges that the defendants "failed to disclose in the CPOM and other solicitation documents the material fact that sales for the three month period ending March 30, 2000 had dropped by approximately 50% from the corresponding period in the previous year." The CPOM was issued on February 8, 2000 and therefore could not have included this information. In addition, as noted above, there is no duty to disclose events occurring in the quarter during which the subject statements are issued. It is true that the court in *In re Quintel Entertainment Inc. Sec. Litig.*, 72 F.Supp.2d 283 (S.D. N.Y. 1999), cited by the plaintiffs, held that a duty to update prior statements may exist when a statement becomes misleading because of a subsequent event, *id*. at 291-92, but in this case the complaint alleges that all of the plaintiffs had already entered into irrevocable purchase agreements before March 30, 2000, Complaint ¶¶ 47-48, 52-53. Accordingly, no duty to disclose the alleged information could have existed at the relevant time by the complaint's own terms. These facts make it unnecessary to consider the sufficiency of the pleading under the PSLRA and First Circuit precedent. Finally, paragraph 86(k) alleges that the defendants failed to disclose the material fact that Acadia was insolvent "at and after February 8, 2000." This allegation lacks the necessary particularly in that no allegation concerning the source of this information is made. To the extent that the allegation may be assumed to rely on any of the factual allegations of insolvency included in prior subsections of paragraph 86, it fails for the reasons discussed above in connection with those subsections.

Paragraph 86(l) alleges that the defendants failed to disclose a material fact "by failing to advise Plaintiffs that at a yet undetermined date in the fiscal quarter ending March 30, 2000, that [sic] Acadia National Health Systems, Inc. lost a substantial customer or customers causing the consolidated sales revenues of Acadia to drop approximately 50%." First, this allegation does not identify any representation rendered false, inaccurate, incomplete or misleading by the claimed omission, and it therefore fails for that reason alone. Next, the allegation fails because it concerns information not available by the very terms of the allegation until after the plaintiffs had made their investments. Finally, the allegation fails because it lacks the necessary particularity and cites no source for the information given or the plaintiffs' belief that the information is true.

Paragraph 86(m) alleges that the defendants omitted a material fact by failing to provide the plaintiffs with Acadia's Form 10QSB for the period ended December 31, 1999 which was filed with the SEC on February 18, 2000 but not delivered to the plaintiffs until a date after March 7, 2000. This report allegedly disclosed "a material adverse event in the form of declining sales, rising operating expenses, operating losses for the three month period then ended of $760,482" and various other specific information. Advest argues that the document at issue was a public document "apparently disclosed to Plaintiffs *prior* to the closing on April 26, 2000." Advest Motion at 23. However, Advest does not identify any section of the complaint or the accompanying documents that establish disclosure of this document to the plaintiffs before the closing, and my review of the complaint has not located any such allegation. In addition, the relevant time for disclosure would appear to be before the plaintiffs made their irrevocable purchases, not before the closing of the offering. The basic problem with paragraph 86(m) is that it fails to identify any representation made false, inaccurate, incomplete or misleading by the information in the February 18, 2000 Form 10QSB. This omission takes on particular significance here because the general rule is that there is no duty to disclose public information. *See, e.g., Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 517 (7th Cir. 1989) ("It is pointless and costly to compel firms to reprint information already in the public domain."); *Acme Propane, Inc. v. Tenexco, Inc.*, 844 F.2d 1317, 1323 (7th Cir. 1988) ("The securities laws require the disclosure of information that is otherwise not in the public domain."); *In re Kulicke & Soffa Indus., Inc. Sec. Litig.*, 697 F. Supp. 183, 186 (E.D. Pa. 1988) ("It is clear that defendants owed no duty to disclose information already available to the public which is part of the total mix of information available to the reasonable investor."). Indeed, the CPOM informs potential investors that they "can read the Company's past and future SEC filings over the Internet at the SEC's web site," giving the address; "read and copy any document filed by the Company at its public reference facilities" in New York City, Washington, D.C., and Chicago; or obtain copies from the SEC at a given address or telephone number. CPOM at [ii].

Having concluded for the foregoing reasons that the defendants are entitled to dismissal of Count V of the complaint, I need not reach the other arguments made in support of the motion.

C. The State Statutory Claims

Count II alleges violation of 32 M.R.S.A. § 10401, which provides: "A person may not offer or sell any security in this State unless the security is registered under this Act, the security or transaction is exempt under this Act or the security is a federal covered security." A transaction is exempt if it does not involve "any public offering within the meaning of the United States Securities Act of 1933, Section 4(2) [15 U.S.C. § 77d(2)] . . ., including . . . any transaction exempt from registration with the United States Securities and Exchange Commission under . . . Rule 506." 32 M.R.S.A. § 10502(2)(R). I have concluded that the complaint concerns such an offering and accordingly the defendants are entitled to dismissal of Count II.

Count VI alleges violation of 32 M.R.S.A. § 10201, which prohibits the use of fraud, untrue statements, material omissions, or deceptive practices in connection with the offer or sale of any security. Although the Maine Law Court has not yet considered this issue, the defendants contend that dismissal of this claim is required if Count V, alleging parallel claims under federal law, is dismissed. Advest Motion at 28-29; Acadia Motion at 23. I do not find it necessary to base my recommendation on this theory. For the reasons set forth in my discussion of Count V above, I conclude that the complaint fails to comply with the requirements of Fed. R. Civ. P. 9(b)[11] on this issue, *see Bohrmann*

[11] The Maine rule is identical. M. R. Civ. P. 9(b). *See also Stevens v. Bouchard*, 532 A.2d 1028, 1030 (Me. 1987) (application of
(*continued on next page*)

v. Maine Yankee Atomic Power Co., 926 F. Supp. 211, 222 (D. Me. 1996) (citing *Romani*), and accordingly I recommend that it be dismissed.

D. State Common Law Claims

Counts VII-IX of the complaint allege state common-law claims of fraud, negligent misrepresentation and breach of contract. The defendants seek dismissal of these claims and, in the alternative, ask the court to decline to exercise jurisdiction over these claims pursuant to 28 U.S.C. § 1367(c)(3). Advest Motion at 29-30 & n.21; Acadia Motion at 23-25. The plaintiffs "agree that the state law claims will have to be pursued in state court if the securities law claims are dismissed." Plaintiffs' Objection at 27. Accordingly, I recommend that the court decline to exercise jurisdiction over these counts pursuant to section 1367(c)(3), which provides:

> The district courts may decline to exercise supplemental jurisdiction over a claim raised under subsection (a) [establishing federal court jurisdiction over state-law claims that are so related to federal-law claims raised in the same action that they form part of the same case or controversy] if —
>
> * * *
>
> **(3)** the district court has dismissed all claims over which it has original jurisdiction.

IV. Conclusion

For the foregoing reasons, I recommend that the defendants' motions to dismiss be **GRANTED** as to Counts I-VI of the complaint and that the court decline to exercise jurisdiction over the remaining counts.

Rule 9(b)).

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. § 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Date this 17th day of July, 2001.

David M. Cohen
United States Magistrate Judge

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the Goodwin Revocable Trust (See above)
plaintiff

HAROLD A MARDEN RALPH A. DYER, ESQ.
plaintiff (See above)

LOIS MARDEN, individually and RALPH A. DYER, ESQ.
ex rel for Andrew M Marden and (See above)
ex rel for Sara L Marden
plaintiff

v.

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EMILE L CLAVET SEAN T. CARNATHAN, ESQ.
defendant (See above)

WILLIAM H. PAINE, ESQ.

(See above)

JEFFREY B. RUDMAN, ESQ.
(See above)

KEVIN B DEAN defendant	SEAN T. CARNATHAN, ESQ. (See above) WILLIAM H. PAINE, ESQ. (See above) JEFFREY B. RUDMAN, ESQ. (See above)