

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

LESTER BAILEY, et al.,)	
)	
Plaintiffs)	
)	
v.)	Civil No. 90-0233 P
)	
LINSCO/PRIVATE LEDGER CORP.,)	
et al.,)	
)	
Defendants)	

RECOMMENDED DECISION ON MOTION TO DISMISS

The plaintiffs bring this action against Linsco/Private Ledger Corporation (ALinsco®), Todd E. Fenstermacher and Roderick A. Robinson alleging that they committed securities fraud violations, fraud violations under the Racketeer Influenced and Corrupt Organizations Act (ARICO®) and several state-law torts. The plaintiffs claim that the defendants knowingly and through fraudulent means and material misrepresentations persuaded them to liquidate certain investments in order to purchase interests in various limited partnerships and tax shelters (collectively referred to herein as Apartnership interests®). The plaintiffs allege that these partnership interests have failed to perform as the defendants projected and that their diminished value has resulted in personal financial losses.

Counts I through IV allege violations of federal security regulations under section 10(b) of the Securities and Exchange Act of 1934¹ and Rule 10b-5 promulgated thereunder,² section 20(a) of the

¹ 15 U.S.C. ' 78j(b).

Securities and Exchange Act of 1934³ and sections 12(2) and 15 of the Securities Act of 1933.⁴ Counts V and VI assert violations under 32 M.R.S.A. ' ' 10201, 10203 of the Maine Securities Act. Count VII alleges RICO violations. Counts VIII through X raise claims under common law fraud, breach of fiduciary duty and negligence. The defendants have moved to dismiss the complaint against them for failure to aver fraud with particularity pursuant to Fed. R. Civ. P. 9(b).

I. Material Allegations

² 17 C.F.R. ' 240.10b-5.

³ 15 U.S.C. ' 78t(a).

⁴ 15 U.S.C. ' ' 77l(2) and 77o.

The material allegations of the complaint may be summarized as follows. The defendants, taking advantage of the plaintiffs' lack of experience in financial dealings, induced them to liquidate certain of their conservative investments and purchase various high-risk partnership interests. Complaint §§ 20, 23-24. This fraudulent activity commenced in October 1988 and continued at least until October 2, 1990. Complaint § 20. The plaintiffs became involved with the defendants when defendant Fenstermacher moved to Rumford, Maine in 1988 and started a financial services business under the name of AMoney Counselling Services, Inc.® Complaint § 21. Fenstermacher allegedly presented himself as an investment advisor associated with Linsco. *Id.* Fenstermacher and defendant Robinson, purporting to be a registered agent with Linsco, persuaded them to accept their investment advice. Complaint § 22. The defendants made false and misleading representations to the plaintiffs in order to induce them to purchase the limited partnership interests, Complaint §§ 25-27,⁵ and the defendants knowingly and with intentional disregard of their needs and objectives advised them to purchase investments which were financially unsuitable for them, Complaint § 29. The plaintiffs did not know, and could not have known, of the misrepresentations and omissions until sometime in 1990. Complaint § 37. Based upon the information they received from the defendants, the plaintiffs made the investments and, consequently, suffered financial losses. Complaint §§ 31-32.

II. Applicable Law

⁵ The plaintiffs list the specific misrepresentations and nondisclosures at §§ 26-27 of the Complaint.

A. Motion to Dismiss

In ruling on a motion to dismiss, the court must take the material allegations of the complaint as true and construe the pleadings in the light most favorable to the plaintiffs. *Roeder v. Alpha Indus., Inc.*, 814 F.2d 22, 25 (1st Cir. 1987); *Chongris v. Board of Appeals of Town of Andover*, 811 F.2d 36, 37 (1st Cir.), *cert. denied*, 483 U.S. 1021 (1987). The motion will be granted only if, when viewed in this manner, the pleading shows no set of facts which could entitle the plaintiffs to relief.⁶ *Gooley v. Mobil Oil Corp.*, 851 F.2d 513, 514 (1st Cir. 1988). The court, however, has no duty to conjure up unpled allegations in order to bolster the plaintiff[s] chances of surviving a 12(b)(6) motion to dismiss.⁶ *Fleet Credit Corp. v. Sion*, 893 F.2d 441, 444 (1st Cir. 1990) (quoting *Gooley*, 851 F.2d at 514). Plaintiffs must set forth factual allegations, either direct or inferential, respecting each material element necessary to sustain recovery under some actionable legal theory.⁶ *Gooley*, 851 F.2d at 515.

B. Pleading Fraud with Particularity

The defendants assert that the entire complaint must be dismissed because each count therein is based on allegations of fraud and the plaintiffs have failed to plead fraud with particularity as required by Fed. R. Civ. P. 9(b). Rule 9(b) mandates that, [i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.⁶ Malice, intent,

⁶ Rule 9(b)'s particularity requirement serves three purposes: (1) to place the defendants on notice and enable them to prepare meaningful responses; (2) to preclude the use of a groundless fraud claim as a pretext to discovering a wrong or as a "strike suit"; and (3) to safeguard defendants from frivolous charges which might damage their reputations.⁶ *New England Data Servs., Inc. v. Becher*, 829 F.2d 286, 289 (1st Cir. 1987).

knowledge and other conditions of mind may be averred generally. The Court of Appeals for the First Circuit has stated A[i]t is well settled that Rule 9 requires specification of the time, place, and content of an alleged false representation, but not the circumstances or evidence from which fraudulent intent could be inferred.⁶ *Wayne Inv., Inc. v. Gulf Oil Corp.*, 739 F.2d 11, 13 (1st Cir. 1984) (quoting *McGinty v. Beranger Volkswagen, Inc.*, 633 F.2d 226, 228 (1st Cir. 1980)). The First Circuit has sounded a particularly cautious note in securities fraud cases: AIn the context of securities litigation, we have expressed the fear that a plaintiff with a largely groundless claim will bring a suit and conduct extensive discovery in the hopes of obtaining an increased settlement, rather than in the hopes that the process will reveal relevant evidence.⁷ *New England Data Servs., Inc. v. Becher*, 829 F.2d 286, 288 (1st Cir. 1987) (citations omitted). Accordingly, in the securities arena the First Circuit has mandated strict compliance with Rule 9(b). *Id.*⁷

III. Discussion

A. Securities Fraud Claims⁸

Applying the First Circuit's Atime, place and content⁶ formulation to the present case, I find

⁷ While the *Becher* court dealt with fraud in the context of RICO rather than general securities fraud law, it stressed that A[t]his degree of specificity is no more nor less than we have required in general fraud and securities fraud cases.⁶ *Becher*, 829 F.2d at 290.

⁸ The elements of a ' 10b-5 action are *scienter*, material omissions and/or representations, reliance and due care by the plaintiff. *Xaphes v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 632 F. Supp. 471, 484 (D. Me. 1986). The elements of a claim under section 12(2) of the 1933 Act are false or misleading statements of material fact made by the defendant (or defendant's failure to state material facts necessary in order to make the statement not misleading), unknown by the plaintiff, which the defendant knew were false or misleading or was in a position to know through the exercise of reasonable diligence. *Xaphes*, 632 F. Supp. at 488.

that the plaintiffs have complied with Rule 9(b) by pleading fraud against these defendants with particularity.

Place: The complaint states that defendant Linsco is a California corporation authorized to do business in Maine as a securities broker and dealer. Complaint ¶ 10. Defendant Fenstermacher resides in West Peru, Maine and defendant Robinson in Albion, Maine. Complaint ¶¶ 11-12. The residence of each plaintiff is set forth in the complaint at ¶¶ 4-9. The complaint states that A[e]arly in 1988 Fenstermacher moved to Rumford, opened a business he called Money Counselling Services, Inc. . . . and thereafter held himself out as an investment advisor associated with Linsco.® Complaint ¶ 21. As agents of Linsco, defendants Fenstermacher and Robinson allegedly sold certain securities to the plaintiffs by use of the mails and interstate wire communications. Complaint ¶¶ 46, 66.

There is scant discussion in the case law regarding the precise requirements of pleading Aplace® with particularity in fraud claims.⁹ However, it appears that, although there must be strict compliance with Rule 9(b) generally, the requirement for pleading the specific Aplace® of the fraud may be more liberally construed than the Atime® and Acontent® components. For example, in *McGinty*, 633 F.2d at 229 n.3, the court apparently found that the Aplace® requirement had been met when the complaint merely set forth the defendant-s business location. Construing the pleadings in the light most favorable to the plaintiffs, I find that the alleged fraud was committed as a result of communications between the defendants and plaintiffs at their respective places of business or residence as set forth in the complaint. Therefore, I conclude that the defendants have received

⁹ In fact, my research has failed to unearth a single case that turned on the plaintiff-s failure to plead Aplace® with sufficient particularity.

sufficient notice as to where the misrepresentations allegedly occurred.

Time: The defendant asserts that the complaint fails to state the time of the alleged fraud with enough particularity to establish compliance with the applicable statutes of limitation.¹⁰ See Defendants=Memorandum in Support of Motion to Dismiss (ADefendants=Memorandum@) at 7. I disagree. Paragraph 20 of the complaint states that the fraudulent activity began in October 1988 and paragraph 37 indicates that the plaintiffs did not discover the misrepresentations and omissions until sometime in 1990 prior to October 2. Taking this assertion as true, the plaintiffs= earliest discovery of the alleged fraud falls within the one-year statute of limitations for ' 12(2) claims and within the two-year statute of limitations for Rule 10b-5 claims.

Content: Finally, the complaint does address the content of the securities fraud with sufficient detail to put the defendants on notice as to the claims against them. The plaintiffs aver that the

¹⁰ The statute of limitations for ' 12(2) claims states that such actions must be brought within one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence, and that no claim may be brought more than three years after the securities sale. 15 U.S.C. ' 77m. Section 10(b) of the Act of 1934 and its correlative rule have no statutorily prescribed limitation period. Federal courts must therefore look to the analogous cause of action under state law to determine the applicable limitation period. *Cook v. Avien, Inc.*, 573 F.2d 685, 694 (1st Cir. 1978). The applicable statute of limitations under Maine law can be found in ' 10606 of the Revised Maine Securities Act, 32 M.R.S.A. ' ' 10101-10711. Section 10606 states that, as to such claims, Asuit must be brought within 2 years after the discovery of the violation or after discovery should have been made by the exercise of reasonable diligence.@

defendants, knowing they were unsophisticated investors, schemed to deceive them into liquidating their conservative investments held for retirement in IRA accounts and purchasing certain limited partnerships and other investments. Complaint & 20. The plaintiffs allege that the defendants induced them to purchase these other investments by making material misrepresentations and by failing to inform them of material information concerning the investments. Complaint && 25, 28-29. They have implicated Linsco as the controlling agency in the fraud under principles of respondeat superior, and defendants Fenstermacher and Robinson as Linsco's agents. Complaint && 21-22. The complaint lists the subject securities at & 24, the alleged misrepresentations at & 26 and alleged omissions at & 27. They further allege that the defendants made the investments on their behalf knowing that they were unsuitable for their needs and objectives. Complaint & 29. The plaintiffs assert that the limited partnership interests acquired for them failed to perform as represented and projected by the defendants and that they have lost value since purchased. Complaint & 31. The plaintiffs contend that, as a consequence, they sustained financial losses. Complaint & 32.

The defendants' argument that the complaint makes only conclusory and not factual allegations of fraud is unfounded.¹¹ A[A] plaintiff is not required to allege "evidentiary details" in his fraud claim.¹² *United Fish*, 627 F. Supp. at 734 (citation omitted).¹² I find that the complaint provides

¹¹ The defendants' reliance on *Romani v. Shearson Lehman Hutton, Inc.*, No. 89-1675-Mc (D. Mass. Sept. 25, 1990) (LEXIS No. 12712) is misplaced. My reading of that case suggests that the complaint contained only general allegations of false statements, misrepresentations and other fraudulent practices. *Id.* at 4. The plaintiffs in the present action, however, have listed specific statements and omissions constituting the fraud.

¹² The defendants argue that the plaintiffs' reliance on *United Fish* is misplaced because that case involved "common fraud" which requires less specificity in pleading than do securities fraud cases. However, *United Fish* involved a RICO claim and, as noted previously, the First Circuit makes no distinction between general fraud, securities fraud and RICO fraud in determining compliance

both direct and inferential factual allegations supporting the plaintiffs' claims. For example, the allegations that the Delchester High Yield Bond Fund was in fact a junk bond fund and not a quality bond fund would, if proved, support the misrepresentation claim. Similarly, if the limited partnership interests were in fact highly speculative and the defendants failed to disclose this information to the plaintiffs, the charge of nondisclosure would be well-founded. In a securities fraud action, information is material if a reasonable investor might have considered [it] important in the making of [the investment] decision. *Roeder v. Alpha Indus., Inc.*, 814 F.2d at 25. The misrepresentations and omissions set forth in the complaint exemplify the type of information that would be important to investors making investment decisions. Taking the allegations of the complaint as true and looking at them in the light most favorable to the plaintiffs, I find that the alleged misrepresentations and omissions adequately allege facts which, if proved, would establish securities fraud as against the defendants.

B. RICO Claim

The defendants assert that the Count VII RICO claim should be dismissed for failure to allege two or more predicate acts of racketeering activity, a pattern of racketeering activity, and a continuous criminal activity. I find that the complaint sufficiently alleges each of these elements. Paragraph 65 of the complaint asserts securities fraud, an act of racketeering activity as defined in 18 U.S.C. § 1961(1)(D). There are eight named plaintiffs and several securities involved in this action. I infer from this that there are multiple acts of securities fraud, all relating to one fraudulent scheme.

with Rule 9(b).

This is sufficient to allege a pattern of racketeering activity.⁶ The Supreme Court most recently defined a pattern of racketeering activity⁶ in *H.J. Inc. v. Northwestern Bell Tel. Co.*, 106 L.Ed.2d 195 (1989). It stated that, in order to prove a pattern of racketeering activity, a plaintiff must show that the racketeering predicates are related, and that they amount to or pose a threat of continued criminal activity.⁶ *Id.* at 208 (emphasis in original). The Court elaborated on the element of continuity⁶ by stating that

A continuity⁶ is both a closed- and open-ended concept, referring either to a closed period of repeated conduct, or to past conduct that by its nature projects into the future with a threat of repetition. . . . A party alleging a RICO violation may demonstrate continuity over a closed period by proving a series of related predicates extending over a substantial period of time. Predicate acts extending over a few weeks or months and threatening no future criminal conduct do not satisfy this requirement.

Id. at 209. In the present action, the alleged scheme was carried out over an almost two-year period.

This is more than a few weeks or months and represents a closed period of repeated conduct.⁶ I find that this satisfies the continuity requirement needed to establish a pattern of racketeering activity. *Cf. Gott v. Simpson*, 745 F. Supp. 765, 771 (D. Me. 1990) (alleged two and one-half month scheme insufficient to establish continuity).

The plaintiffs allege that the defendants are part of an enterprise engaged in or affecting interstate commerce through the fraudulent sales of certain securities and that the sales were conducted through a pattern of racketeering activity. Having previously determined that the acts of security fraud were pleaded with sufficient particularity, I conclude that the plaintiffs have stated a RICO claim under 18 U.S.C. ' 1962(c).

V. Conclusion

For the foregoing reasons, I recommend that the defendants-motion to dismiss the complaint be **DENIED**.

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.

Dated at Portland, Maine this 5th day of February, 1991.

*David M. Cohen
United States Magistrate Judge*