COMMODITY FUTURES TRADING COMMISSION, Plaintiff, v. ROBERT JOSEPH BEASLEY AND LONGBOAT GLOBAL FUNDS MANAGEMENT, LLC; Defendants.

No. C 05-2142 PJH

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SAN FRANCISCO DIVISION

2005 U.S. Dist. Ct. Motions 94642; 2005 U.S. Dist. Ct. Motions LEXIS 46419

July 25, 2005

Motion to Dismiss

COUNSEL: [*1] ROBERT S. LAWRENCE (State Bar No. 207099), COLLETTE ERICKSON FARMER & O'NEILL LLP, San Francisco, California, TIMOTHY J. CAREY, DAVID W. PORTEOUS, GARDNER CARTON & DOUGLAS LLP, Chicago, IL, (Pro Hac Vice), Attorneys for Defendants, ROBERT JOSEPH BEASLEY and LONGBOAT GLOBAL FUNDS MANAGEMENT, LLC.

JUDGES: Hon. Phyllis J. Hamilton

TITLE: DEFENDANTS' NOTICE OF MOTION; MOTION TO DISMISS OR MORE DEFINITE STATEMENT PURSUANT TO FED. R. CIV. P. 8(a), 8(e), 9(b) AND 12(e); MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

TEXT: TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that, on August 24, 2005, at 9:00 a.m., or as soon thereafter as the matter may be heard in the above-entitled court, located at 450 Golden Gate Avenue, San Francisco, California 94102, Defendants Robert Joseph Beasley and Longboat Global Funds Management, LLC, will move this court, pursuant to *Fed. R. Civ. P. 8(a)*, *8(e)*, *9(b)* and *12(e)*, to dismiss the Complaint in this matter or, in the alternative, for a more definite statement.

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT

I. INTRODUCTION

On May 24, 2005, the Commodity Futures Trading Commission (the "CFTC" or the [*2] "Commission") filed a one-count Complaint against defendants, Joseph Beasley ("Beasley") and Longboat Global Funds Management LLC ("Longboat"). The Complaint alleges violations of Sections 4o(1)(A) and 4o(1)(B) of the Commodity Exchange Act, *7 U.S.C. ß 1*, *et seq* (the "Act"). The operative allegations of the Complaint for purposes of this motion are found at paragraphs 67, 68 and 70:

67. Since December 31, 2002, Defendant Longboat, while acting as a CPO, and Defendant Beasley, while acting as an AP of Longboat employed a device, scheme or artifice to defraud pool participants and prospective pool participants, in violation of Section 4o(1)(A) of the Act, *7 U.S.C. ß 6*o(1)(A).

68. Since December 31, 2002, Defendant Longboat, while acting as a CPO, and Defendant Beasley, while acting as an AP of Longboat, engaged in a transaction, practice or course of business which has operated as a fraud or deceit upon pool participants and prospective pool participants, in violation of Section 4o(1)(B) of the Act, *7 U.S.C. ß 6*o(1)(B)

70. The foregoing acts, misrepresentations, omissions and failures of [*3] Beasley occurred within the scope of his person's employment or office with Longboat. Longboat is therefore liable for these acts pursuant to Section 2(a)(1)(B) of the Act, *7 U.S.C. ß 2(a)(1)(B)*. Each material misrepresentation or omission made during the relevant time period by Beasley, including, but not limited to, those specifically alleged herein, is a separate and distinct violation of Section 4o(1)(A) and (B).

Except for the allegations relating to the mistaken disclosures in the Annual Reports of Piranha for 2002 and 2003 relating to the security for the promissory notes with the Beasley related entities, neither these paragraphs nor any other paragraphs of the Complaint specify the instruments as to which defendants purportedly made misrepresentations or omissions. Instead the Complaint alleges a litany of purported facts and representations without specifying which if any of those representations were false or misleading and without identifying the specific conduct or alleged misrepresentations for which the Commission seeks to hold the defendants liable. As the Commission asserts in paragraph 70, however, it seeks to hold defendants liable not [*4] only for conduct specified in the Complaint but for "[e]ach material misrepresentation or omission made during the relevant time period by Beasley, including, but not limited to, those specifically alleged herein." By its own words, the Commission establishes that the Complaint does not meet the pleading specifications of either Fed.R.Civ. P. 8 or 9. As demonstrated below therefore the Complaint should be dismissed, or in the alternative, pursuant to *Fed. R. Civ. P. 12(e)* the Commission should be ordered to provide a more definite statement of its claims against defendants.

II. ARGUMENT

A. The Complaint Does not Meet the Requirements of Fed. R.Civ.P. 8

Fed. R.Civ.P. 8(a) requires every pleading that states a claim for relief to contain a short and plain statement of the claim showing that the pleader is entitled to relief. Rule 8(e) further requires that each averment of a pleading shall be simple, concise and direct. Claims such as the CFTC's here that are subject to heightened pleading requirements are not excepted from this requirement of simplicity, directness and clarity. *McHenry v. Renne, 84 F.3d 1172 (9th Cir. 1996).* Thus, where the allegations [*5] of the Complaint make it difficult to determine just what actions were supposed to have given rise to the cause of action, dismissal is appropriate. Alternatively, when a pleading is so vague or ambiguous that a party cannot reasonably be required to frame a responsive pleading, the court may order that a more definite statement be provided and if the pleader fails to comply, dismiss the Complaint. *See* Fed.R.Civ.P 12(e).

The Commission has submitted a single-count, seemingly concise Complaint. In fact, however, with the exception of the allegations relating to the alleged misrepresentations regarding security for the Beasley-related notes, the Complaint fails to advise the defendants of the alleged wrongs for which the Commission seeks to hold them liable. Instead, the Complaint recites a litany of purported facts, representations and omissions without stating in detail - or otherwise - whether the Commission is alleging the representations or omissions to be false, material, willful or in any way violative of Sections 4o(1)(A) or 4o(1)(B). For example, paragraph 15 of the Complaint alleges that in Piranha's private placement memorandum, Longboat states that Piranha is a newly [*6] organized limited partnership "that will invest in publicly traded securities and other financial instruments." Nowhere in the Complaint, however, does the Commission allege that the statements to which it adverts are false. Similarly, Paragraph 16 of the Complaint alleges "specifically, the memorandum states that Piranha 'is designed for private investors with a high net worth, as a means to diversify their portfolios with highly liquid portfolio securities with high return potential." Again, there is no allegation in the Complaint that this representation was false at the time it was made in the PPM or at any other time. Instead, paragraphs 67 and 68 make a sweeping and conclusory allegation of violations of Sections 4o(1)(A) or 4o(1)(B).

Even more unfairly, paragraph 70 alleges that the Commission seeks to hold defendants liable for alleged misrepresentations or other alleged misconduct that is not even mentioned in the Complaint. The Commission's intention to expand the scope of the Complaint without repleading was made clear in its memorandum in support of its application for a statutory restraining order. There the Commission asserted:

> [T]he Defendants misrepresented [*7] and failed to disclose certain facts to pool participants regarding the condition and security of Piranha's assets. Specifically, Beasley directed and approved loans totaling approximately $ 4 million to entities he controls without fully disclosing to pool participants his relationship to these entities. Upon expiration of these notes, Beasley disregarded his duties to Piranha pool participants when he failed to collect the interest or principal due on the notes in a timely manner. Lastly, despite not collecting the monies owed the pool by his companies under the notes, Beasley used the value of the unpaid interest payments to calculate his management and incentive fees. At this time, while interest continues to accrue and go unpaid, pool participants remain at risk since the pool's promissory notes remain unsecured.
>
> Through the conduct described above, Longboat, through the acts of Beasley, and Beasley has each violated the anti-fraud provisions of the Commodity Exchange Act ... .

Plaintiffs' Memorandum of Points and Authorities in Support at 1.

Pleadings, however, may not be amended by memoranda. *See U.S. Concord, Inc. v. Harris Graphics Corp., 757 F. Supp. 1053, 1061 (N.D. Cal. 1991)* [*8] (disregarding allegations in memorandum in opposition to motion to dismiss that were not contained in complaint as insufficient to cure complaint's Rule 9(b) deficiencies). Rather they must be amended by formal pleading. Further, since the pleadings define the scope of discovery and of the admissible evidence at the later stages of the action, if the Commission intends to seek relief based on allegations of fraud that are not alleged, the Complaint must be amended.

In short, the allegations of the Complaint make it difficult to determine just what conduct or circumstances are supposed to have given rise to the Commission's cause of action. Defendants are entitled to fair notice of the alleged misconduct for which they are being called to account. The Complaint fails to provide that notice and should be dismissed pursuant to Fed. R. Civ.P. 8. Alternatively, the Court should order the Commission to file a more definite and complete statement of its claims against defendants pursuant to Fed.R.Civ.P. 12(e).

B. The Complaint Fails to Plead Fraud with the Particularity Required by Rule 9(b).

1. The Heightened Pleading Standards of Rule 9(b)

Even if the Court determines that [*9] the Complaint meets the pleading requirements of Rule 8, it nonetheless must be dismissed for failure to comply with Fed.R.Civ.P 9(b). Rule 9(b) provides that: "[i]n 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." Rule 9(b) must be read together with Rule 8(a) which requires a "short and plain statement" of the claims for relief. *Ouaknine v. MacFarlane, 897 F.2d 75, 79 (2d Cir.1990).* Rule 9(b) has been stringently enforced by courts in order to accomplish three goals: (1) to provide notice of the claim to the defendant; (2) protect the defendant's reputation from harm; and (3) minimize strike suits and fishing expeditions. *See U.S. ex rel. Harrington v. Sisters of Providence in Oregon,* Case No. 98-1587-*JO, 2001 WL 34041791,* at *2 (D. Or. Dec. 21, 2001) (attached in the appendix of unreported cases). To satisfy Rule 9(b), therefore, the allegations in a Complaint must be specific enough so that the defendant can defend against the charge and not just deny that they have done anything wrong. [*10] *See Vess v. Ciba-Geigy Corp. USA, 317 F.3d 1097, 1106 (9th Cir. 2003).* In other words, the Complaint must state the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation. *Schreiber Distributing Co., v. Serv-Well Furniture Co., Inc., 806 F.2d 1393, 1401 (9th Cir. 1986).* Importantly, where allegations have been made against multiple defendants, the Complaint must apprise each individual defendant of the specific nature of their participation in the alleged fraud. *Comwest Inc. v. American Operator Services, Inc., 765 F. Supp. 1467, 1472 (C.D.Cal. 1991).*

2. The Complaint Fails to Plead Sufficient Facts Regarding Defendants' Intent to Establish a Claim under Section 4o(1)(A)

To plead a claim for violation of section 4o(1)(A) of the Act, the CFTC must allege a (1) a misrepresentation or omission (2) of a material fact (3) with the intent to deceive. *See 7 U.S.C. ß 6o(1)(A)*; *Messer v. E.F. Hutton & Co., 833 F.2d 909, 919 (11th Cir. 1987).* Intent to commit fraud, or scienter, is present under Section 4o(1)(A) when "Defendant's [*11] conduct involves highly unreasonable omissions or misrepresentations . . . that present a danger of misleading [customers] which is either known to the Defendant or so obvious that Defendant must have been aware of it." *CFTC v. R.J. Fitzgerald, 310 F.3d 1321, 1328 (11th Cir. 2002). See also Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990)* ("[R]eckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.").

Thus, in order to state a claim under Section 4o(1)(A) against both Longboat and Beasley, the CFTC must at least plead facts demonstrating Longboat and Beasley either had knowledge of the falsity of the alleged misstatements or that it was so obvious they must have been aware of it. *See Sunnyside Development Co., LLC v. Opsys Limited,* Case No. 05-0553-*MHP, 2005 WL 947720,* at * 3 (N.D.Cal. Apr. 22, 2005) (holding that for purposes [*12] of Rule 9(b), the plaintiff must allege the defendant possessed the requisite scienter for the alleged fraud) (attached in appendix of unreported cases). As noted above, the Complaint focuses almost exclusively on the notes relating to the Beasley related entities. Nowhere does it specify any details relating to the other notes in which Piranha invested. Nowhere does it allege that Beasley (as opposed to Longboat) had actual knowledge of the content or status of the promissory note investments originated by Boucher. Nor does the Complaint allege that Longboat or Beasley either possessed knowledge of the fact that all the promissory notes in which the Fund invested were unsecured at the time the 2002 and 2003 Annual Reports were issued or that it was so obvious they should have been aware of it. *See Hollinger, 941 F.2d at 1569.* To the contrary, the Complaint alleges that the Annual Reports were prepared by an outside source, not Longboat and Beasley, and that Beasley only signed the Annual Reports. Complaint, P 47. The Complaint thus fails to plead a claim as to Section 4o(1)(A) with the particularity required under Rule 9(b). Absent further allegations that Longboat [*13] or Beasley knew or must have known the falsity of the information contained in the Annual Reports, therefore, the Complaint fails to inform Defendants of the precise grounds for the fraud claim against them under Section 4o(1)(A) concerning the Fund's investment in all the promissory notes and should be dismissed.

3. The Complaint Fails to Plead All of the Elements of a Claim under Section 4o(1)(B)

Section 4o(1)(B) prohibits investment advisers from "engag[ing] in any transaction, practice or course of business which operates as a fraud or deceit upon any client." Courts have interpreted Section 4o(1)(B) as not requiring proof of intent because the "operates as" language focuses upon "the effect of the action rather than on the actor's state of mind." *See Messer, 833 F.2d at 919.* Nonetheless, a plain reading of the language of also Section 4o(1)(B) also makes clear that in order for a transaction, practice or course of business to act as a fraud on a client, the client must have relied on that conduct. *See CFTC v. Heffernan, 245 F. Supp. 2d 1276, 1291 n. 24 (S.D. Ga. 2003). See also Messer, 847 F.2d at 679* (finding plaintiff [*14] failed to demonstrate defendant's conduct "operated as fraud or deceit" upon plaintiff); *First Nat. Monetary Corp. v. Weinberger, 819 F.2d 1334, 1340 (6th Cir. 1987).* Moreover, the Commission is seeking restitution from Longboat and Beasley (Complaint, part VII, P d), which necessarily requires the Commission to plead and prove that Fund investors relied upon and suffered losses proximately caused by Longboat and Beasley's alleged misconduct. *See 7 U.S.C. ß 9* (authorizing Commission to seek restitution "of damages proximately caused by violations of such persons"); *also In the Matter of Staryk, Case No. 95-5, 1997 WL 778236,* at * 13 (C.F.T.C. Dec. 18, 1997) (finding, in administrative proceeding, that "reliance is a statutory requirement of restitution.") (attached in appendix of unreported cases). Thus, in order for the CFTC to state a claim for a violation of Section 4o(1)(B) and for an award of restitution, it must allege and ultimately prove that the Fund's investors relied on the allegedly fraudulent transaction, practice or course of business.

The Complaint does not allege, however, that even a single Fund investor relied [*15] upon the statements in the 2002 and 2003 Annual Reports concerning the security for any of the promissory notes invested in by the Fund. In addition to failing to plead the alleged fraud with respect to the Boucher-related notes with particularity and the attempt to obtain relief for misconduct that is not alleged in the Complaint through the all-encompassing Paragraph 70, the Complaint also fails to state a claim for violation of Section 4o(1)(B) of the Act or that the Commission is entitled to restitution so that the Complaint should be dismissed.

C. In the Alternative, the CFTC Should Be Compelled to File a More Definite Statement of the Facts Pursuant to Rule 12(e)

Assuming, without conceding, that the Complaint somehow satisfies the pleading requirements of Rule 9(b) as to a fraud regarding all the promissory notes under sections 4o(1)(A) and 4o(1)(B), nonetheless the Court should require the CFTC to amend the Complaint with a more definite statement of the facts to eliminate the ambiguities in the Complaint so that Defendants may adequately respond. Under Rule 12(e) "[i]f a pleading . . . is so vague or ambiguous that a party cannot reasonably be required to frame a [*16] responsive pleading . . . the court may strike the pleading[]." Fed.R.Civ.P. 12(e). Thus where, as here, a Complaint does not provide the defendant with a sufficient basis to frame its responsive pleadings, a motion pursuant to Rule 12(e) should be granted. *See Aureflam Corp. v. Pho Hoa Heip Inc.,* Case No. 04-03824-*JW, 2005 WL 1562933,* at *2 (N.D.Cal. June 23, 2005); *see also Wood v. Apodaca,* Case No. C 05-1344-*PVT, 2005 WL 1561370,* at *6 (N.D.Cal. June 23, 2005) (both of which are attached in the appendix of unreported cases).

As discussed above, the Complaint fails to notify Longboat and Beasley as to the precise nature of the fraud they allegedly committed with respect to all the notes in which the Fund invested for purposes of establishing a claim under either Section 4o(1)(A) or 4o(1)(B) of the Act. As an alternative to dismissing the Complaint, therefore, and to enable Defendants to answer the general allegations of fraud the CFTC contends are embodied in the Complaint, the Court should simply compel the CFTC to amend the Complaint to clarify its general fraud claims.

III. CONCLUSION

For all of the foregoing reasons, Defendants [*17] Longboat Global Funds Management, LLC and Robert Beasley respectfully request that the Court dismiss the CFTC's Complaint for failure to plead its claims for fraud under the Act with the requisite particularity under Rule 9(b) or, in the alternative, compel the CFTC to amend the Complaint with a more definite statement of the facts upon which its claims of fraud are based.

Dated: July 25, 2005

GARDNER CARTON & DOUGLAS, LLP

/s/ David W. Porteous
Timothy J. Carey
David W. Porteous
Attorney for Defendants
Robert Joseph Beasley
Longboat Global Funds Management, LLC

[SEE APPENDIX OF UNREPORTED CASES IN ORIGINAL]