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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 893025; 2005 U.S. Dist. Ct. Motions LEXIS 46422

November 8, 2005

Motion to Dismiss

VIEW OTHER AVAILABLE CONTENT RELATED TO THIS DOCUMENT: U.S. District Court: Motion(s); Pleading(s)

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 Defendant, ROBERT JOSEPH BEASLEY.

JUDGES: Hon. Phyllis J. Hamilton

TITLE: DEFENDANT'S NOTICE OF MOTION; MOTION TO DISMISS PURSUANT TO FED. R. CIV. P. 12(b)(6) and 12(f); MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

TEXT: TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that, on December 21, 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, Defendant Robert Joseph Beasley will move this court, pursuant to *Fed. R. Civ. P. 12(b)(6)* to dismiss the Amended Complaint and/or in the alternative certain allegations of the Amended Complaint should be stricken pursuant to *Fed. R. Civ. P. 12(f)*.

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT

I. INTRODUCTION

Pursuant to this Court's September 6, 2005 Order (the "Order") granting Defendants' Motion for More Definite Statement, the Commodity Futures Trading Commission [*2] ("CFTC") was directed to file an amended complaint setting forth "in a logical order the facts supporting the allegations of fraud at issue in this case (namely, whether plaintiff claims that defendants defrauded investors in all transactions or only the transactions concerning Beasley-related entities)." Despite the clear requirements of the Order, the CFTC now attempts to add new, but defective, claims against Longboat and Beasley for fraudulent omissions.

In a single count, the Amended Complaint - like the initial Complaint - alleges identical conduct in violation of Sections 4o(1)(A) and (B) of the Commodity Exchange Act (the "Act"), *7 U.S.C. ßß 6o(1)(A)* and (B). The CFTC's now avers that Longboat and Beasley failed to disclose to the Piranha Capital, L.P. Fund (the "Fund") participants in either the 2002 or 2003 Annual Reports or any other communication to Fund participants that: (1) "Beasley disregarded his duties to pool participants when he failed to collect the interest and principal payments for the Beasley controlled notes in a timely manner;" and (2) "Longboat and Beasley used the value of the unpaid interest payments on the Beasley-controlled notes [*3] to calculate his management and incentive fees." Amended Complaint, PP 66, 67, subparas. 3 and 4. These new claims for purported fraudulent omission (the "Alleged Omissions") fail to state a claim upon which relief can be granted and must be dismissed because:

. The alleged omission that Beasley "disregarded" or breached his "duties" to collect on the Beasley Notes is an unsubstantiated legal conclusion;

. Defendants disclosed the allegedly omitted facts in the annual reports and in communications with investors;

. The Amended Complaint fails to and cannot establish that the alleged omissions constituted "material" facts in light of the total mix of information actually disclosed;

. The Amended Complaint fails to allege the source of Longboat's or Beasley's duty to disclose the purportedly omitted information to the Fund; and

. The CFTC is improperly attempting to bootstrap claims for breach of fiduciary duty into claims for fraudulent omission under the Act.

For each of these independent reasons, the Amended Complaint should be dismissed and the CFTC ordered to amend its complaint, again.

II. ARGUMENT

A. Standards For Motion to Dismiss [*4] and Motion to Strike

On a motion to dismiss under Rule 12(b)(6), the factual allegations of the complaint are generally presumed to be true and all factual inferences are drawn in plaintiff's favor. *In Re Pacific Gateway Exchange, Inc. Secs. Litig., 169 F. Supp. 2d 1160, 1164 (N.D. Cal. 2001).* While a court's review of the complaint is typically limited to the allegations of the complaint, where, as here, a plaintiff fails to attach documents referred to in the complaint and upon which the complaint is premised, the documents are properly considered part of the complaint. *See Fed. R. Civ. P. 10(c).* On a motion to dismiss, therefore, a defendant may attach to its motion to dismiss documents referred to or relied upon by the complaint to show that the documents do not support plaintiff's claim without converting the motion to dismiss into one for summary judgment. *See Pacific Gateway, 169 F. Supp. at 1164; also Parrino v. FHP, Inc., 146 F.3d 699, 706 (9th Cir. 1998).* Further, if the allegations of the complaint are contradicted by the documents, then the documents control and the court need not accept as true the contrary allegations [*5] of the complaint. *See Informix Software, Inc. v. Oracle Corp., 927 F. Supp. 1283, 1285 (N.D. Cal. 1996).* Similarly, the court need not accept as true unreasonable inferences or conclusory allegations of law cast in the form of factual allegations. *See Miranda v. Clark County, Nev., 279 F.3d 1102, 1106 (9th Cir. 2002).* As an alternative to dismissing the complaint, pursuant to Rule 12(f), the court may also strike conclusory allegations from the complaint that fail to give defendants fair notice of plaintiff's claim and the grounds upon which it rests. *Reyn's Pasta Bella, LLC v. VISA USA, Inc., 259 F. Supp. 2d 992, 1002-03 (N.D. Cal. 2003).* Applying these standards here, it is clear that the CFTC has not alleged sufficient facts in support of its claims of fraudulent omission to entitle it to relief so that the Amended Complaint should be dismissed. *See Conley v. Gibson, 355 U.S. 41, 45-46 (1957).*

B. The Alleged Fraudulent Omissions Fail To State a Claim for Violation of the Act.

1. The Alleged Omission That Beasley "Disregarded" or Breached His "Duties" to Collect on The Notes Is An Unsubstantiated Legal [*6] Conclusion.

The CFTC complains that Longboat and Beasley failed to disclose to investors that "Beasley disregarded his duties to pool participants when he failed to collect the interest and principal payments for the Beasley controlled notes in a timely manner." Amended Complaint, PP 66, 67, subpara. 3. The conduct of which the CFTC complains, however, is nothing more than a series of legal conclusions strung together by an undefined duty Beasley purportedly owed the Fund, namely, that: (1) Beasley owed some duty to disclose collection efforts with respect to notes issued to the Fund by entities he controlled; (2) Beasley "disregarded" or breached that duty; and (3) Beasley failed to disclose his breach.

Neither paragraphs 66 nor 67 of the Amended Complaint, nor any other paragraph of the Amended Complaint, allege the factual predicate upon which Beasley owed this duty of "timely" collection, the circumstances culminating in his "disregard" of that duty or the failure to disclose collection efforts with respect to the notes. The only related allegations upon which this alleged fraudulent omission could conceivably be based are themselves predicated upon conclusory legal statements [*7] concerning Beasley's "failure to enforce" the notes, his "disregard of his duties" and his "failure to collect" on the notes. *See* Amended Complaint, PP 60, 61, 62. Even if these "failures" constituted omissions of material facts - they do not -, none of these statements provide the requisite factual detail necessary to give Longboat and Beasley fair notice of the claims set forth in sub-paragraph 3 of paragraphs 66 and 67. Rather, the CFTC has simply posited in conclusory fashion the alleged breach committed by Beasley. On this basis alone, therefore, the alleged fraudulent omission concerning Beasley's breach of his duties to the Fund, set forth in sub-paragraph 3 of paragraphs 66 and 67, should be disregarded and dismissed as unsubstantiated legal conclusions. *See Miranda, 279 F.3d at 1106.* Alternatively, the Court should strike these allegations pursuant to Rule 12(f), albeit with leave to re-plead. *See Reyn's Pasta Bella, 259 F. Supp.2d at 1002-03.*

2. Defendants Disclosed the Allegedly Omitted Facts in the Annual Reports and in Communications with Investors.

The CFTC complains that Longboat and Beasley failed to disclose the Alleged [*8] Omissions in the 2002 and 2003 Annual Reports "or in any other communications" with investors but then fails to attach either the reports or any "communications" to the Amended Complaint. Amended Complaint, PP 4, 66, 67, sub-paras. (3) and (4) (emphasis added). A review of the Annual Reports and other communications referred to in the Amended Complaint, which the CFTC provided to the Court in previous filings, demonstrates the falsity of the CFTC's allegations.

a. Longboat and Beasley Disclosed Facts Concerning the Collection of the Beasley Notes.

The allegation that Longboat and Beasley failed to disclose to the Fund the collection status of the notes issued to the Fund by Beasley-controlled entities (the "Beasley Notes") (Amended Complaint, PP 66, 67) is patently untrue. The 2002 and 2003 Annual Reports repeatedly treat all the promissory notes held by the Fund as well as the interest due on the notes as "receivables" of the Fund; the Annual Reports did not represent that the principal or accrued interest on the notes had been collected, received or paid. *See* Exhibits 1 (2002 Annual Report) and 2 (2003 Annual Report), pp. 2, 3, 8 (Note 5) and 9 (Note 6).

Further, [*9] in complaining about Beasley's lack of disclosure regarding the collection status of the Beasley Notes, the CFTC implicitly acknowledges that the alleged omissions were cured by subsequent disclosures. Specifically, in paragraph 60 of the Amended Complaint, the CFTC alleges that:

> **Until July 2, 2004,** Beasley, as president of Longboat, Piranha's general partner, failed to disclose to pool participants in any Annual Report or in any other communication that he had failed on Piranha's behalf to enforce the terms of the Beasley controlled notes and to collect the principal and interest at the time it was owed to Piranha.

(Emphasis added). Implicit in this allegation is that in a communication to pool investors on July 2, 2004, Beasley fully disclosed the collection status of the notes. In fact, the CFTC attached that communication as Exhibit 14 to its Motion for Preliminary Injunction and Statutory Restraining Order. In that letter, Longboat and Beasley unambiguously stated that "[w]ith the exception of one of the related party notes, none of the notes have been repaid. The notes have been routinely renewed after their original stated maturity date." *See* attached [*10] Exhibit 3 (July 2, 2004 letter from Longboat to investors, signed by Beasley). Because the Amended Complaint acknowledges and refers to the July 2, 2004 letter to investors, it is properly considered part of the Complaint. *See Fed. R. Civ. P. 10(c)*; *Pacific Gateway, 169 F. Supp. at 1164.*

In light of the "receivable" status applied to all the promissory notes in the Annual Reports as well as the unequivocal language in the July 2, 2004 letter to the Fund, the allegation that Beasley failed to disclose the collection status of the Beasley Notes in any communication with the Fund should be disregarded and the Amended Complaint dismissed. *See id.*

b. Longboat and Beasley Repeatedly Disclosed that the Calculation of Incentive and Management Fees Was Based Upon Unpaid Accrued Interest.

The Commission also alleges that Longboat and Beasley failed to disclose in "the annual reports or in any other communications with participants" that the value of the unpaid interest payments were used to calculate the management and incentive fees (Amended Complaint, PP 62, 66 and 67, subpara. 4). Again, the CFTC has failed to attach the communications with investors referred [*11] to in the Amended Complaint that clearly demonstrate this fact was disclosed.

In paragraphs 15-17 of the Amended Complaint, the CFTC quotes selectively from the Fund's Private Placement Memorandum ("PPM") dated January 12, 2001, but then fails to attach the PPM to the Amended Complaint. Because the Amended Complaint relies upon the PPM, the document in its entirety is incorporated into the Complaint and must be considered by the Court in ruling on this motion to dismiss. *See Fed. R. Civ. P. 10(c)*; *Pacific Gateway, 169 F. Supp. at 1164.* The PPM contained various disclosures regarding the calculation of management and incentive fees based on the fund's net asset value, including unrealized and realized gains. It states:

> Management Fee and Incentive Allocation ... The Fund will pay the General Partner a monthly management fee at the annual rate of 2% of the net asset value ("NAV") of the Fund (0.1667% per month).
>
> . . . .
>
> Incentive Allocation. ... Your capital account might be charged an incentive allocation for one or more quarters during a particular year even though the account was not profitable on an overall basis for the entire year. Because [*12] the allocation is **based on unrealized as well as realized gains,** the General Partner could earn an incentive allocation based on positions that were unprofitable when eventually liquidated.

See attached Exhibit 4 (January 12, 2001 PPM), respectively, ß 1, p. 3; ß 2, p. 5 (emphasis added).

In addition, in the July 2, 2004 letter to investors, Longboat and Beasley tacitly explained that management fees calculated using the Net Asset Value of the Fund included unpaid interest on the notes:

> Longboat charges its management fees based on the net asset value of the Fund and its incentive fees based on the increase in such Net Asset Value from the prior period. Net asset value includes the outstanding principal value of the notes held by the Fund and **the unpaid accrued interest on such notes as assets in such calculations.**

See Exhibit 1 (emphasis added). Accordingly, the allegations of the Amended Complaint that Longboat and Beasley failed to disclose the manner in which they calculated incentive and management fees should be dismissed as documents relied upon by the Amended Complaint establish Longboat and Beasley did indeed disclose these facts. [*13]

3. The Amended Complaint Fails to and Cannot Establish that the Alleged Omissions Constituted "Material" Facts In Light of the Total Mix of Information Actually Disclosed.

In order to be actionable under Section 4o(1)(A) or (B), a misstatement or omission of fact must be "material." *Messer v. E.F. Hutton & Co., 833 F.2d 909, 919 (11th Cir. 1987); see also Basic Inc. v. Levinson, 485 U.S. 224, 238 (1988).* As the CFTC itself has acknowledged, the relevant question is whether a reasonable investor would have considered the allegedly omitted information to be important to his investment decision in light of the "total mix" of information in his possession. *Sudol v. Shearson Loeb Rhoads, Inc., [1984-1986 Transfer Binder], Comm. Fut. L. Rep. (CCH) P 22,748, at 31, 118-119* (CFTC Sept. 30, 1985) (*citing TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976))*

(other citations omitted). Further, the materiality of undisclosed information may be determined as a matter of law. *See Benzon v. Morgan Stanley Distributors, Inc., 420 F.3d 598, 608-09 (6th Cir. 2005).*

Here, the Amended Complaint does [*14] not contain any allegation regarding how, if at all, the Alleged Omissions constituted "material" information, *i.e.,* reasonably important to an investor's decision in light of the "total mix" of information disclosed. On this basis alone, the Amended Complaint should be dismissed.

Further, as discussed in Section II.B.2 above, the "total mix" of information available to investors contained in documents referred to or relied upon by the Amended Complaint, included:

> . The Annual Reports which routinely treated all the promissory notes as receivables and not as collected items;
>
> . The Private Placement Memorandum, dated January 12, 2001, explaining that management and incentive fees were calculated monthly based upon the Fund's NAV and that the incentive allocation was based on "unrealized as well as realized gains;" and
>
> . The July 2, 2004 letter to investors in which Longboat and Beasley explained that: (i) only one of the related party notes had been repaid; (ii) that management and incentive fees were based on the Fund's NAV; and (iii) the NAV included the outstanding principal value of the notes held by the Fund and that the unpaid accrued interest on such notes [*15] were treated as assets in calculating the NAV.

All of these disclosures necessarily impacted the "total mix" of information available to the Fund's investors so as to render any remaining non-disclosure about these matters insignificant as a matter of law. For this additional reason, the Amended Complaint should be dismissed. *See, e.g., Benzon, 420 F.3d at 609* (rejecting plaintiffs' claims where the disclosures plaintiffs alleged should have been made did not provide any new information, and thus, would not have significantly altered the total mix of the information already presented).

4. The Amended Complaint Fails to Allege the Source of Longboat's or Beasley's Duty to Disclose the Purportedly Omitted Information to the Fund.

Assuming solely for purposes of this analysis that the Alleged Omissions were material, it is well established that no liability exists absent a duty to disclose. *See, e.g., Farmland Indus. v. Frazier-Parrot Commodities, Inc., 871 F.2d 1402, 1410* (8th cir. 1989) (finding duty to disclose alleged material facts as element of claim for fraudulent omission under the Commodity Exchange Act); *Basic, 485 U.S. at 239 n. 17* [*16] (stating in context of fraud under the Securities Exchange Act that "[s]ilence, absent a duty to disclose, is not misleading"). Yet, the Amended Complaint does not contain any allegation regarding the source of Longboat's or Beasley's purported duty to disclose these facts to investors in the Annual Reports or other communications with investors. Absent such allegations, the Amended Complaint fails to state a claim for fraudulent omission under either Section 4o(1)(A) or (B) and, therefore, these claims as stated in paragraphs 66 and 67 should be dismissed.

5. The CFTC is Improperly Attempting to Bootstrap Claims for Breach of Fiduciary Duty into Claims For Fraudulent Omission under the Commodity Exchange Act.

At its core, the Alleged Omissions involve Beasley's non-disclosure of his purported breach of fiduciary duties owed to the Fund. The non-disclosure of such a fact does not, however, amount to a violation of the Commodity Exchange Act. In short, the CFTC cannot bootstrap what is at best a state law claim for breach of fiduciary duty into one for federal commodities fraud under the Act. Any attempt to do so perforce must fail.

Interpreting the general anti-fraud provision [*17] of the Securities Exchange Act, the U.S. Supreme Court in the seminal case of *Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977)* held that traditional state law breach of fiduciary duty claims are not actionable under Section 10(b), *15 U.S.C. ß 78j(b)*, unless the conduct alleged can fairly be viewed as "manipulative or deceptive" within the meaning of Section 10(b). *430 U.S. at 473-74.* "Deceptive" conduct, the Court held, requires an omission or misstatement of a material fact; "manipulative" conduct refers to practices "intended to mislead investors by artificially affecting market activity." *Santa Fe, 430 U.S. at 474-76.* The Court, to avoid creating federal common law of fiduciary obligations, stressed that Congress did not intend to take over for the states as corporate regulator through Section 10(b). *Id. at 477-79; see also Data Probe Acquisition Corp. v. Datatab, Inc., 722*

F.2d 1, 4 (2d Cir. 1983). Thus, absent allegations of deceptive or manipulative conduct, a claim asserting a breach of fiduciary duty does not give rise to liability under the anti-fraud provisions of [*18] the Securities Exchange Act.

Since *Santa Fe,* the Circuit Courts of Appeal have repeatedly rejected attempts to bootstrap a failure to disclose the misconduct giving rise to the breach of fiduciary duty itself or any impure motive behind a breach of fiduciary duty as an actionable omission of material fact for purposes of Section 10(b). As the Seventh Circuit has explained:

> In the wake of *Santa Fe,* courts have consistently held that since a shareholder cannot recover under 10b-5 for breach of fiduciary duty, neither can he "bootstrap" such a claim into a federal securities action by alleging that the disclosure philosophy of the statute obligates defendants to reveal either the culpability of their activities, or their impure motives for entering the allegedly improper transaction.

Panter v. Marshall Field & Co., 646 F.2d 271, 288 (7th Cir. 1981). See also Field v. Trump, 850 F.2d 938, 947-48 (2d Cir. 1988) (rejecting shareholders attempts to "bootstrap" breach of fiduciary duty into claim under Section 10(b) where the alleged "material" omissions were that the corporation's directors and officers had breached their fiduciary [*19] duties to the shareholders); *Kas v. Financial Gen. Bankshares, Inc., 796 F.2d 508, 513 (D.C. Cir. 1986)* ("plaintiff may not bootstrap a claim of breach of fiduciary duty into a federal securities claim by alleging that directors failed to disclose that breach of fiduciary duty"). The critical issue, therefore, is not whether the defendant breached a fiduciary duty or failed to disclose a breach of duty or the reason behind such breach, but "whether the conduct complained of includes the omission or misrepresentation of a material fact." *Panter, 646 F.2d at 288.*

The principles expressed by *Santa Fe* and its progeny logically extend to the anti-fraud provisions of the Commodity Exchange Act at issue in this proceeding. Indeed, the anti-fraud language of the Act is virtually identical to the language employed in the regulations implementing Section 10(b) of the Securities Exchange Act. *Cf. 7 U.S.C. ßß 6o(A)* and (B) (prohibiting, respectively, "any device, scheme or artifice to defraud" and engaging in "any transaction, practice or course of business which operates as a fraud or deceit"); *with 17 C.F.R. ßß 240.10b-5(a)* and [*20] (c) (prohibiting, respectively, any "device, scheme or artifice to defraud" and "any act, practice, or course of business which operates or would operate as a fraud or deceit"). *See also Kearney v. Prudential-Bache Secs., Inc., 701 F. Supp. 416, 422-23 (S.D.N.Y. 1988)* (noting the similarity of the anti-fraud language of Section 10(b) of the Securities Exchange Act and Section 4o of the Commodity Exchange Act). Thus, in considering the Alleged Omissions, the Court should observe the principles announced in *Santa Fe* and reject the CFTC's unwarranted attempt to expand federal anti-fraud liability under the Commodity Exchange Act to encompass a state law claim for breach of fiduciary duty.

Indeed, in its Amended Complaint, the Commission alleges only that Beasley failed to disclose a purported breach of fiduciary duty and his financial motives for doing so, specifically by alleging that: (1) he disregarded his duty to collect on the Beasley Notes in a timely manner and (2) while he failed to collect on the unpaid notes, he continued to receive management and incentive fees calculated on the value of the unpaid notes. Amended Complaint, PP 60-62. Neither act of alleged [*21] mismanagement or breach of fiduciary duty rises to the level of deceptive or manipulative conduct as required by *Santa Fe* and *Panter* to be actionable fraud under the Commodity Exchange Act. *See Coronet Ins. Co. v. Seyfarth, 665 F. Supp. 661, 667-68 (N.D. Ill. 1987)* (following *Santa Fe* and *Panter* and granting Rule 12(b)(6) motion to dismiss claim under Section 10(b) as improper "bootstrapping" of claim for breach of fiduciary duty). For this additional reason, the Alleged Omissions set forth in the Amended Complaint should be dismissed with prejudice.

III. CONCLUSION

For all of the foregoing reasons, Defendant Robert Joseph Beasley respectfully requests that the Court dismiss the Amended Complaint for failure to state a claim pursuant to Rule 12(b)(6) and to strike pursuant to Rule 12(f) the CFTC should be ordered to amend its complaint, again.

Dated: November 8, 2005

GARDNER CARTON & DOUGLAS, LLP

/s/ David W. Porteous
Timothy J. Carey

David W. Porteous
Attorney for Defendant
Robert Joseph Beasley

[SEE Exhibit 1 IN ORIGINAL]

[SEE Exhibit 2 IN ORIGINAL]

[SEE Exhibit 3 IN ORIGINAL]

[SEE Exhibit 4 IN ORIGINAL] [*22]