

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

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| C. CLARK HODGSON, JR., RECEIVER | : | CIVIL ACTION |
| | : | |
| v. | : | |
| | : | |
| THOMAS GILMARTIN, et al. | : | NO. 06-1944 |

MEMORANDUM RE: MOTION TO DISMISS

Baylson, J.

October 5, 2006

This case was filed by C. Clark Hodgson, Jr., Esquire, (“Hodgson”), Receiver for the Philadelphia Alternative Asset Management Company, LLC (“PAAMCo”) against Man Financial, Inc. (“Man”) and seven of its employees, as a related case to an enforcement action earlier brought by the Commodity Futures Trading Commission (“CFTC”) against PAAMCo and its former President, Paul M. Eustace (“Eustace”), Civil Action No. 05-2973.

Promptly after the filing of the CFTC Complaint, Judge Padova of this Court appointed Hodgson as the Receiver in an order dated June 23, 2005. Man, which provided brokerage, trading and other financial services to PAAMCo, was promptly served with a subpoena and various proceedings related to its response to that subpoena took place under Civil Action 05-2973. Subsequently, Hodgson requested and received permission from this Court, to bring this action against Man and its employees, making various allegations.¹

As the Court advised counsel, the Court allowed discovery to proceed in the present case

¹When the Court granted Hodgson permission to initiate the action against Man, the undersigned made it clear to the parties that it was without any endorsement of the merits of the case, and that continues to be the situation.

because it was clear to the Court from the allegations of the Complaint and the Court's knowledge of Man's role in this matter from the proceedings in the CFTC case, that the Complaint adequately stated a claim against Man for negligence (alleged in Count I of the Complaint). The Court did not make any further decisions on the sufficiency of the other counts alleged.

This Court has previously denied Man's Motion to Transfer Venue to the Northern District of Illinois by Memorandum dated September 18, 2006, 2006 WL 2707397. Although denying that motion, the Court reviewed a number of documents which had been submitted and made some rulings that may be relevant to understanding the relationships amongst the parties.

Presently before this Court are the Motions to Dismiss the Complaint filed by Thomas Gilmartin and the other Defendants under Federal Rule of Civil Procedure 12(b)(6) alleging that Plaintiff's Complaint fails to state a claim upon which relief can be granted.

I. Brief Factual Background and Summary of Complaint

PAAMCo was established in June 2004 by Eustace. PAAMCo acted as manager for a number of offshore funds, including the major fund, entitled the Philadelphia Alternative Asset Fund Limited, which is known as the "Offshore Fund." The Complaint alleges that Man is a futures commission merchant ("FCM") through which the Offshore Fund traded commodity futures and options.

The CFTC alleged that PAAMCo and Eustace had engaged in a number of wrongful and fraudulent acts that caused investor losses of over \$147 million. Hodgson, in turn, alleges that Man, through acts and omissions, is responsible for at least some of those losses. (Compl. ¶ 2.) Man has moved to dismiss the Complaint in its entirety for a number of separate reasons.

The Complaint further alleges that Eustace, operating through PAAMCo, operated the Offshore Fund and the other funds, headquartered in the Cayman Islands, which allowed customers in the United States to participate in the Offshore Fund. (Compl. ¶ 15.) The Complaint alleges that Eustace was advising investors through his website of profitable net returns whereas in fact he was losing substantial amounts of money (Compl. ¶ 18) and that Defendants, by their acts and/or omissions, are liable to Hodgson as Receiver.

The headings of the Complaint give a summary of the allegations which Hodgson makes against Man:

1. Man permitted the improper opening of the Offshore Fund accounts. (Compl. ¶¶ 20-30.) Included in these paragraphs is an allegation that UBS Fund Services (Cayman) Limited (“UBS”), the Offshore Fund’s administrator, received trading results from Man that were not accurate through its internet-based E-Midas system.

2. Man assisted in the back-dating of certain trades and failed to keep the requisite records of these transactions. (Compl. ¶¶ 31-51.) In particular, paragraph 38 alleges as follows:

Man Financial’s participation in artificially inflating the reported returns of the Offshore Fund caused investors in the Offshore Fund and Feeder Fund, as well as investors in Option Capital and the LP Fund, to continue to invest and/or remain invested in the respective funds from January 31, 2005, through the June 23, 2005, appointment of the Receiver. Man Financial prevented the investors in the Offshore Fund, the Feeder Fund, Option Capital and the LP Fund (collectively, the “Receivership Funds”) from mitigating their losses by allowing Eustace, acting individually and through PAAMCo, to artificially inflate month-end returns and allowing Eustace, acting individually and through PAAMCo, to utilize misleading returns in the Offshore Fund to calculate and distribute false financial information to investors in Option Capital, the LP Fund and the Feeder Fund.

3. Man allowed Eustace to restrict access to the 50 Account via the E-Midas system and failed to advise UBS of the 50 Account. (Compl. ¶¶ 40-51.) The Complaint alleges that

Man set up two accounts known as the 10 Account and the 50 Account, but allowed massive losses to accumulate unnoticed in the 50 Account, which artificially increased the Offshore Fund's returns. (Compl. ¶ 49.)

4. Man facilitated trading between the 10 Account and the 50 Account. (Compl. ¶¶ 52-66.) The Complaint alleges that, because the 10 Account was transparent and the 50 Account was hidden, Man allowed Eustace to cancel and move positions between the accounts in order to hide losing transactions in the 50 Account. (Compl. ¶ 65.)

5. Man failed to advised certain investors or potential investors of the true value of the Offshore Fund accounts. (Compl. ¶¶ 67-71.)

6. Man hid the 50 Account from PAAMCo's board of directors and employees. (Compl. ¶¶ 72-75.)

7. Man failed to monitor and evaluate the risks posed by the trading and other activities in the Offshore Fund's accounts. (Compl. ¶¶ 76-81.)

8. Man made errors in liquidating the Offshore Fund accounts. (Compl. ¶¶ 82-88.)

9. Man failed properly to supervise its employees. (Compl. ¶¶ 89-90.)

II. Jurisdiction

The Court has jurisdiction pursuant to 28 U.S.C. § 1331, as the case involves causes of action arising under federal law, and 28 U.S.C. § 1332, since the suit is between citizens of different states and the matter in controversy exceeds \$75,000, exclusive of interest and costs.

III. Legal Standard

When deciding a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), the Court may look only to the facts alleged in the complaint and its attachments. See Jordan v.

Fox, Rothschild, O'Brien & Frankel, 20 F.3d 1250, 1261 (3d Cir. 1994). The Court must accept as true all well-pleaded allegations in the complaint and view them in the light most favorable to the plaintiff. Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939, 944 (3d Cir. 1985). A Rule 12(b)(6) motion will be granted only when it is certain that no relief could be granted under any set of facts that could be proved by the plaintiff. Ransom v. Marrazzo, 848 F.2d 398, 401 (3d Cir. 1988).

With respect to Man's allegations of fraud, these allegations must comply with the standard set out under Federal Rule of Civil Procedure 9(b), which provides that, "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." This requirement of particularity in the pleadings requires a plaintiff to plead the circumstances surrounding the alleged fraud in order to put the defendant on notice of the precise misconduct at issue. See Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984).

IV. Discussion of Allegations

The Court notes that under general principles of notice pleading, except for the allegations of fraud, the above headings alone, without the detailed paragraphs included within the headings, would suffice as notice pleading under Federal Rule of Civil Procedure 8. The parties have gone through extensive briefing, parsing out various allegations and discussing the pros and cons of actual operations, instead of limiting argument to the allegations of the Complaint.

Indeed, the statement in Man's reply brief, "plaintiff repeatedly accuses defendants of 'hiding losses' from the Offshore Fund, even though he knows that this accusation is false,"

starkly demonstrates disregard of the proper standard. (Defs.' Reply 3-4.) Other parts of the brief contain similar attacks on the credibility and the accuracy of the Plaintiff's allegations. Both parties seem to have forgotten that the Court is only ruling on the Motion to Dismiss where its duty is to accept the well pled allegations of the Complaint, whether they are true or not.

The Court has determined that an extensive review of the arguments in the briefs would, for most of the claims presented, serve no purpose. The Complaint alleges that Man had undertaken certain duties to the Offshore Fund and to other entities involved in this case. Plaintiff has adequately alleged injury to the Offshore Fund, in that Man had a contract with the Offshore Fund (which is discussed in the Court's prior Opinion on the Motion to Transfer Venue), was subject to the standard of care that all brokerage firms have to their clients, and that Defendants' acts and/or omissions resulted in losses to the Offshore Fund and its investors.²

There are a number of claims that are clearly sufficient simply as a matter of notice pleading. These include Count I, alleging simple negligence against Man; Count II, alleging negligent supervision against Man; Count III, alleging respondeat superior against Man; and

²The Court notes that Plaintiff has not claimed breach of contract despite the existence of a contractual relationship between Man and the Offshore Fund under the Customer Agreement. Perhaps Plaintiff proceeded exclusively on a tort theory because, when the Complaint was filed, Plaintiff did not believe that he, as Receiver, was bound to this agreement. Plaintiff contended that Eustace was not authorized to sign this agreement on behalf of the Offshore Fund. However, now that the Court has ruled that Plaintiff is bound to the contract by ratification, the Plaintiff may wish to consider whether he intends to proceed exclusively on a tort theory or wishes to seek leave to amend his Complaint to add a breach of contract claim. In this connection, there are a number of cases that restrict tort claims when the parties have a contractual relationship, under what is frequently called the "gist of the action" doctrine. See Michael M. Baylson, Kelly D. Eckel, and Sandra A. Jeskie, 6 Business and Commercial Litigation in Federal Courts § 68:8 (2d ed. 2005) (chapter co-authored by the undersigned on this topic). Man has resolutely asserted from the onset of this case that Plaintiff was bound to this contract. In view of the fact that the Court is denying Defendants' Motion to Dismiss, this issue can be developed further on summary judgment.

Count IV, alleging negligence against the employee Defendants. The allegations of Count V, alleging violations of the Commodity Exchange Act against Man and the allegations of Count VI, alleging aiding and abetting those violations, are discussed below.

Counts VII and VIII, charging respectively common law fraud and aiding and abetting common law fraud against Man, must be judged by the standards of particularity pursuant to Federal Rule of Civil Procedure 9(b). Count IX, charging violations of the RICO Statute, 18 U.S.C. § 1962(c) and (d) against Man and the employee Defendants, will be examined more closely. Count X, alleging “deepening insolvency against Man Financial and the employee Defendants,” will also be separately discussed.

Defendants have asserted that Plaintiff does not have standing to assert the claims in the Complaint. The thrust of this argument is that the Receiver, who this Court has previously held stands in the shoes of the Offshore Fund, is bound by the status and actions taken by the Offshore Fund. Under this principle, the Court has previously found that the Receiver was bound by the Offshore Fund’s ratification of the various agreements entered into by the Offshore Fund and Man. 2006 WL 2707397, at *10. The allegations of the Complaint, although stated broadly, do encompass a number of statements and representations made by Man and its employees to the Offshore Fund and related entities, that the Offshore Fund became aware of Man’s improper actions and statements, even if not made directly to the Offshore Fund, and these caused injury to investors. Defendants seem to forget that the Receiver was specifically appointed to assemble the assets of the Offshore Fund, including litigation claims, and distribute all recovered assets to the investors. The Court views the issue of standing to be primarily one of causation, and it remains to be seen through summary judgment and trial whether Plaintiff can prove that

Defendants' acts and/or omissions caused injury to the Offshore Fund and/or investors, remembering that at the moment the Court is only dealing with allegations.

Man asserts in its brief that the Complaint fails to allege any misrepresentation or omission of material fact to the Offshore Fund. (Pl.'s Br. 3-7). This is not a fair reading of the Complaint, which as the Court has held satisfies notice pleading requirements and also ignores, for example, the effect of paragraph 38 which is quoted in full above, as well as many other paragraphs.

Man's motion ignores the thrust of specific allegations, ignores the principle of notice pleading, and also ignores the fundamental principle that on a 12(b)(6) motion, the Court should construe a complaint in the light most favorable to the plaintiff. Except for the more specific claims of fraud, the violation of the Commodity Exchange Act and RICO, the more appropriate battleground should be on summary judgment rather than a motion to dismiss.

Accordingly, the Court finds that Plaintiff has alleged sufficient facts to warrant the Court concluding that Plaintiff has sufficiently alleged standing and that Man and its employees must defend the claims involving negligence.

A. Commodity Exchange Act Claims

In Count V Plaintiff alleges that Man violated the anti-fraud provisions of the Commodity Exchange Act, §§ 4b(a) and 4c(b), 7 U.S.C. §§ 6b(a) and 6c(b) and the regulations promulgated thereunder, 7 C.F.R. § 33.10.³ In Count VI, Plaintiff further alleges that Defendants aided and abetted Eustace in violating the same provisions as well as those anti-fraud provisions found in

³ CEA § 4b(a) governs commodity futures contracts, and § 4c(b), along with 17 C.F.R. § 33.10, governs options contracts.

Section 4o(1)(A) of the CEA. 7 U.S.C. § 6o(a)(A).⁴ Because this is a somewhat novel claim, not frequently alleged, the Court will consider Man’s grounds for dismissal and Plaintiff’s response in some detail.

1. Receiver’s Standing to Bring Claims Under the CEA

Subsection 22(a)(1) of the CEA, 7 U.S.C. § 25(a)(1) creates a private right of action for any plaintiff who suffers actual damages as a result of any person’s willful violation of a provision of the CEA and who stands in one of four relationships with respect to the person being sued. See Nicholas v. Saul Stone & Co., 224 F.3d 179, 186 (3d Cir. 2000). Each of these relationships, enumerated in 7 U.S.C. § 25(a)(1)(A)-(D), “involves the ‘person’ sued having given advice related to the sale of commodities, or having participated in a transaction related to such sales.” Id. The statute provides that a person can bring a private suit against an individual who violated the CEA if he or she:

- (A) received trading advice from such person for a fee;
- (B) made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;
- (C) purchased from or sold to such person or placed through such person an order for the purchase or sale of--
 - (I) an option subject to section 6c of this title (other than an option purchased or sold on a registered entity or other board of trade);
 - (ii) a contract subject to section 23 of this title; or
 - (iii) an interest or participation in a commodity pool; or
- (D) purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

7 U.S.C. § 25(a)(1).

⁴ CEA § 4o deals with fraud committed by commodity trading advisors and pool operators. 7 U.S.C. § 6o(1).

In its Motion, Man argues that there were no actionable misrepresentations under the CEA alleged in the Complaint because, with one exception, those alleged misrepresentations were directed at persons or entities other than the Offshore Fund. These third parties included the Fund's investors, the Fund's administrator, UBS, a potential investor in the Fund, and certain PAAMCo personnel. (Defs' Mot. 58.) With respect to the single allegation that specifically alleges that Man deceived the Fund's directors (Compl. ¶ 79), Defendants contend that this allegation is false because the monthly account statements Man mailed to the registered office of the Fund contained accurate information about the Fund's subaccounts, including the 50 Account. (Defs'. Mot. 58-59.)

As for the alleged misrepresentations to third parties, Defendants argue that such allegations are insufficient to state a cause of action for fraud against Man because Man owed no duty to any of these third parties to disclose information about the Offshore Fund's accounts. Instead, Defendants argue that under the CFTC rules, a futures commissions merchant has a duty to provide monthly account statements only to its customer or to the entity controlling the account, in this case, the Offshore Fund and PAAMCo itself. 17 C.F.R. § 1.33(a). Moreover, since providing internet account access is optional under the applicable CFTC guidelines, 17 C.F.R. § 1.33(g), and Man was acting under the specific instructions of Eustace when it limited access to the 50 Account, Man had no duty to provide this information to UBS, underlying investors, potential investors, or employees at PAAMCo. (Defs.' Mot. 63.)

Finally, Man contends that Plaintiff, as the court-appointed Receiver of the Fund, lacks standing to bring claims under the CEA because the claims he is asserting belong to the individual investors in the receivership funds. (Defs' Mot. 64.) Even if Plaintiff had the

standing to assert claims on behalf of the investors against Man, none of the entities that were allegedly defrauded, including UBS, PAAMCo, and underlying investors and potential investors, would have standing to assert individual claims against Man because these third parties did not stand in one of four relationships with the Defendants required for standing as described in 7 U.S.C. § 25(a)(1)(A)-(D).

According to Plaintiff, the Complaint sufficiently alleges that the Fund, and therefore the Receiver, has standing to sue under 7 U.S.C. § 25(a)(1)(B) and (D). Plaintiff notes that a Receiver stands in the shoes of the entities he has been appointed to oversee, in this case the Fund. (Pl.s' Br. 46.) Plaintiff then points to the paragraph in the Complaint that describes how the relationship between Man and the Fund falls into two of the four categories described in the CEA for the Fund to have standing: that the Fund made "contracts of sale of commodities for future delivery (and options on such contracts or any commodities) and deposited with or paid to Man Financial money in connection with orders to make such contracts," and that the Fund further "purchased or sold such contracts under circumstances where Man Financial manipulated the price of such contracts." (Pl.'s Br. 46-47; Compl. ¶ 123.)

Plaintiff also challenges Defendants' contention that Plaintiff is asserting claims on behalf of the Fund's investors and not for injuries sustained by the Fund directly. Plaintiff asserts that the Fund has no need to rely on an indirect third-party standing argument because the crux of the Complaint involves how Man defrauded the fund itself. (Pl.'s Br. 47.) According to the Plaintiff, because UBS was the Fund's administrator, "[i]n both a practical and legal sense . . . misleading UBS Cayman was the same as misleading the Offshore Fund." (Pl.'s Br. 10.) Man's alleged deceptions with respect to UBS concealed the Fund's losses and therefore precluded the

Fund from taking action to stem those losses, which resulted in harm to the Fund.

In their Reply, Defendants reiterate their argument that the Complaint does not show any injury to the Fund and instead pleads that Man's conduct injured the investors of the Offshore Fund. (Def.'s Reply 41.) On this basis, Defendants contend, the Plaintiff does not have standing to bring a complaint under the CEA.

While it is true that Plaintiff's allegations are almost exclusively related to how Man deceived UBS with respect to the status of the Fund's accounts, and not to how Man deceived the Fund directly, Plaintiff's response that the deceptions committed against UBS as the Fund's administrator function as misrepresentations to the Fund itself is sufficient at the 12(b)(6) stage. The nature of this relationship and the extent to which the Fund relied exclusively on the reports of UBS, as opposed to the statements mailed to the Fund's designated office, is a factual issue that survives a 12(b)(6) motion.

With respect to standing, as noted above, this Court has already held in its September 18, 2006 opinion on Defendants' Motion to Transfer Venue, that the Receiver stands in the shoes of the Fund for purposes of this action, and is charged with seeking to assemble and distribute Fund assets, including claims the Fund has against other parties, such as Defendants in this case. Furthermore, the Third Circuit has held that, "in order for a plaintiff to sue a defendant for directly violating subsection 22(a)(1), the defendant must have violated the CEA, and (2) stand in an appropriate relationship to the plaintiff with respect to the violative conduct." Nicholas, 224 F.3d at 186. As pointed out by the Plaintiff, the language of the Complaint in paragraph 123 tracks the language of the statute as set out in § 22(a)(1) of the CEA and thus alleges that the Fund has a least two of the four possible relationships with Man as required under the statute.

Defendants' argument, that the Receiver lacks standing because it is essentially asserting claims on behalf of the investors, is rejected. As Judge Fullam noted with respect to a claim brought under the Securities Exchange Act, "So long as double recoveries are avoided, I see no reason why the Receiver should be precluded from proceeding against wrongdoers who damaged [plaintiff] by increasing its liabilities, merely because, eventually, any recovery by the Receiver would enure to the benefit of the defrauded investors." Marion v. TDI, Inc., 2004 WL 1175740, at *3 (E.D. Pa. May 27, 2004).

As for Defendants' argument the Complaint fails to allege actual injury to the Fund, the Complaint specifically states that the Fund suffered losses as a result of Defendants' deceptive acts. (Compl. ¶¶ 1-2, 17-19, 51.) Whether Plaintiff can prove causation, and if so, the nature and extent of those losses, is an issue that survives a 12(b)(6) motion.

2. The "In Connection With" Requirement Under the CEA

A claim for fraud under Section 4b(a) of the Commodities and Exchange Act must set forth allegations that defendants wilfully engaged in fraudulent conduct "in connection with any order to make or the making of any contract of sale of any commodity." 7 U.S.C. § 6b(a)(i)-(iii); CFTC v. Am. Metal. Exh. Corp., 693 F. Supp. 168, 193 (D.N.J. 1988) ("American Metal I") (emphasis added). To meet the "in connection with" requirement under Section 4b(a), a plaintiff must show both a transaction related to the sale of commodity and a link between that transaction and the fraudulent acts at issue. See Kearney v. Prudential-Bache Sec., 701 F. Supp. 416, 422 (S.D.N.Y. 1988). Such a link exists where the "alleged fraud concern[s] the fundamental *nature* of the commodity futures contract: namely, the characteristics and attributes that would induce an

investor to buy or sell the particular commodity futures contract.” Id., 701 F. Supp. at 424.

Defendants contend that Plaintiff failed to allege a fraud committed “in connection with” an order to make or the making of a commodity futures or option contract as required by §§ 4b(a), 4c(b), and 4o(1)(A) of the CEA. (Defs.’ Mot. 66.) Defendants argue that the Complaint fails to allege a “direct link” between the alleged fraud and the trading of commodities futures because there is no allegation that Man’s alleged misrepresentations caused the Offshore Fund to engage in futures and options trades. Instead, Defendants assert that the fraudulent conduct induced underlying investors to purchase shares in the Fund itself. These shares are securities, not commodity futures contracts or option contracts, and therefore are one step removed from the commodity contracts themselves. (Defs.’ Mot. 67.) Defendants further argue that an allegation that a plaintiff held its futures positions, as opposed to buying or selling them, does not satisfy the “in connection with” requirement under the CEA anti-fraud provisions.

Plaintiff responds that the Complaint meets the “in connection with” requirement of the CEA because Man’s allegedly fraudulent account statements misled the Fund about the profitability of the Fund’s commodity futures or option contracts. (Pl.’s Br. 59-60.)

Defendants’ reply asserts that there were no misrepresentations about the Fund’s profitability because Man provided accurate account statements to the Fund by mailing them to the Fund’s designated office. (Def.’s Reply 46.)

Plaintiff cites Schwartz v. O’Grady, 1990 WL 156274, at *12-13 (S.D.N.Y. Oct. 12, 1990), to support his argument that the allegations in the Complaint satisfy the “in connection with” requirement. In Schwartz, a group of commodity investment funds brought a claim alleging fraud under the CEA against the responsible future commodity merchant for issuing

misleading monthly statements about the profitability of the funds' investments. The district court found this satisfied the "in connection with" requirement: "Here, the alleged fraud induced plaintiffs to maintain their investments and thus, to continue to trade in commodities. A misrepresentation concerning the profitability of the contracts is indisputably a misrepresentation concerning the fundamental nature of the futures contract." *Id.* at *13. While this case was decided on a summary judgment standard, the facts are close enough to the facts alleged here to warrant denial of Defendants' Motion on this issue.

As discussed above, the extent to which the Fund relied on the reports issued by UBS on the status of its investments as opposed to the statements mailed to it by presents a factual issue. Under a 12(b)(6) standard, the Complaint sufficiently alleges a link between Man's alleged fraudulent conduct and a commodity futures or options contract.

3. Alleging Elements of Common Law Fraud

In order to state a claim for fraud under Section 4b(a) of the Commodities and Exchange Act, a plaintiff must allege that defendants wilfully engaged in fraudulent conduct "in connection with any order to make or the making of any contract of sale of any commodity." 7 U.S.C. § 6b(a)(i)-(iii). Section 4c(b) of the CEA further prohibits any person from entering into any transaction involving an option transaction that is "contrary to any rule, regulation, or order of the Commission," while the regulations promulgated thereunder specify that it is unlawful for any person to defraud another with respect to "an offer to enter into, the entry into, the confirmation of the execution of, or the maintenance of, any commodity option transaction." 17 C.F.R. § 33.10; *CFTC v. Rosenberg*, 85 F. Supp. 2d 424, 445 (D.N.J. 2000).

The elements of a claim for fraud under the CEA correspond to those required to

establish common law fraud. See American Metal I, 693 F. Supp. at 194; Horn v. Ray E. Friedman & Co., 776 F.2d 777, 780 (8th Cir. 1985). Therefore, a plaintiff must allege that a defendant made a (1) false representation of a material fact to the plaintiff, (2) that defendant knew that representation was false at the time he or she made it, (3) that defendant intended for plaintiff to rely on that misrepresentation, and (4) that plaintiff actually relied on that misrepresentation. American Metal I, 693 F. Supp. at 194; Rosenberg, 85 F. Supp. 2d at 446.

With respect to the requirement of knowledge or scienter, the plaintiff need not show, however, that defendant acted with “an evil motive or an intent to injure.” American Metal I, 693 F. Supp. at 194. A district judge in New Jersey has held that “recklessness is sufficient to satisfy the scienter requirement of Section 4b of the CEA.” CFTC v. Am. Metals Exh. Corp., 775 F. Supp. 767, 775 (D.N.J. 1991) (“American Metal II”), aff’d in relevant part, 991 F.2d 71 (3d Cir. 1993); cf. Rosenberg, 85 F. Supp. at 448 (acknowledging recklessness standard adopted by one of court’s colleagues but finding that “the more lenient recklessness standard is unnecessary since there is overwhelming evidence that [defendant’s] misrepresentations were made intentionally and with knowledge of their falsity”).

Defendants challenge almost every part of Plaintiff’s allegations with respect to common law fraud. First, Defendants argue that Plaintiff’s Complaint fails to plead causation because it does not set forth how Defendants’ alleged violation of the CEA caused the Fund to suffer actual injury. (Def’s. Mot. 69.) Defendants argue that the \$147 million in losses in the 50 Account were not the result of fraudulent trades and instead were the result of the bad investment decisions made by Eustace and PAAMCo. (Defs.’ Mot. 69.) In fact, Defendants contend that the alleged fraudulent conduct actually benefitted the Fund by allowing it to raise additional

money from investors. Second, according to Defendants, the Complaint also fails to allege justifiable reliance on Man's misrepresentations by the Fund. (Defs.' Mot. 70.) Man states that, because it mailed monthly account statements to the Fund's registered office, the Fund either knew or could have learned about the activity in both the 10 and 50 Accounts. Third, Defendants argue that the Complaint failed to adequately plead scienter, that Man had the intent to deceive, manipulate or defraud the Offshore Fund. (Defs.' Mot. 71.)

Plaintiff challenges Defendants' arguments that the Complaint does not sufficiently set forth the elements of common law fraud. First, the Plaintiff contends that Man's alleged issuance of false reports, statements, and account balances constitute material misrepresentations and that the fraudulent misrepresentations or omissions allegedly made to UBS, as the Fund's administrator, are misrepresentations to the Fund under an agency theory. According to Plaintiff, the Fund as the principal has a right of action against Man for those misrepresentations made to UBS as its agent. (Pl.'s Br. 48-49.) Plaintiff also notes that the issuance of accurate monthly statements in compliance with CFTC regulations to the Fund's designated office did not allow Man to commit fraud elsewhere, as Plaintiff alleges occurred with respect to the E-Midas statements made available to UBS on the internet. (Pl.s' Br. 51-52).

Second, Plaintiff argues the Complaint sufficiently sets out how Man made misrepresentations and omissions with the required knowledge of their falsity. (Pl.'s Br. 52.) Plaintiff points to places in the Complaint where it alleged that Man knew that it was giving a false reports to UBS regarding the true trade date of certain trades, that it facilitated trading between the 10 Account and 50 Account and received commissions from these trades even though they never took place on the market, that individuals at Man knew that such trading was

fraudulent, and that Man knew it was omitting a material fact when it restricted UBS's access to the 50 Account. (Pl.'s Br. 52-54.)

Third, Plaintiff points out that the Complaint sufficiently set forth that Man intended for the Fund to rely on its statements in order to induce it to continue trading so that Man could continue to receive commissions on those trades. (Pl.'s Br. 55.)

Fourth, Plaintiff states that the Complaint alleged reasonable reliance when it alleged that the Fund relied on information provided by Man Financial to UBS about the status of its accounts on the E-Midas system. (Pl.'s Br. 56.)

Fifth, Plaintiff alleges that the Complaint sufficiently alleges that the Fund suffered damages as a result of Defendants' actions where the Fund, relying on the information provided to it through Man's E-Midas system via UBS, continued to use Eustace and PAAMCo as its trading advisors. (Pl.'s Br. 57.) As the Complaint alleges in paragraph 164, if the Fund had known the true status of its accounts, it would have ceased trading with Eustace. Finally, Plaintiff points out that the Complaint alleges that the Fund was charged for trades that never took place. (Pl.'s Br. 58.)

In their reply, Defendants respond that neither the agency theory upon which Plaintiff largely relies to establish its claim of violations of the CEA nor the Plaintiff's assertion that it relied exclusively on the information from UBS as its agent in order to track the performance of its investments, as opposed to the monthly account statements that were sent to its designated office, does not appear anywhere in the Complaint. (Defs.' Reply 42-43.) Defendants further respond that the Complaint fails to set forth that Man intended to mislead the Fund via its misrepresentations to UBS or knew that the Fund was relying exclusively on the information

provided to UBS via E-Midas to track its accounts. (Defs.' Reply 44-45.) The Complaint does not show justifiable reliance where, according to Defendants, there were no allegations that Man's alleged misrepresentations induced Plaintiff to buy, sell, or hold commodities futures or options positions. (Defs.' Reply 46.) Plaintiff's contention that Man's acts mislead it with respect to the Fund's profitability is not sufficient in light of the fact that Man provided the Fund with accurate account statements. (Defs.' Reply 46.)

The Complaint is sufficient to meet the elements of pleading for common law fraud under the heightened particularity requirement of Rule 9(b). The Complaint describes in detail how Man restricted UBS's access to the 50 Account, assisted Eustace in trading between the two accounts, and allowed Eustace to backdate certain trades. In light of the exhibits attached to the Complaint, which both parties agree the Court has the power to consider in deciding this motion, Plaintiff has sufficiently detailed a claim that Man knew that the information they were providing to UBS was false. Even without these exhibits, this is a factual issue that survives a 12(b)(6) motion.

Furthermore, arguments that the Fund did not justifiably rely on Man's statements or suffer injury, because of those statements, raise factual issues about the extent to which the Fund relied on UBS for information about its accounts and about whether the monthly statements sent to the Fund's designated office were actually seen, or should have been seen, by the Fund's directors. Accordingly, these allegations survive Defendants' motion to dismiss.

4. Aiding and Abetting a Violation of the CEA

Section 22(a)(1) of the CEA creates a private right of action against a person who willfully aids or abets another in a violation of the provisions of the CEA. 7 U.S.C. § 25(a)(1).

According to the Third Circuit, the elements of a claim for aider and abetter liability under the CEA track those set out under the federal criminal aid and abetter statute, 18 U.S.C. § 2. See Nicholas v. Saul Stone & Co., 224 F.3d 179, 189 (3d Cir. 2000). Therefore, a plaintiff alleging aider and abetter liability under the CEA must allege (1) that the Defendants knew of the principal's intent to violate the CEA, (2) that the Defendants intended to further that violation, and (3) that the Defendants committed an act in furtherance of that violation. Id. Allegations that defendants acted recklessly or should have known of primary violations of the CEA are insufficient to state a claim for aider and abetter liability. Id. at 190.

With respect to Count VI, Defendants argue that the Complaint has failed to state a claim for aiding and abetting a primary violation under the CEA because the Complaint (1) fails to show a primary violation of the CEA by Eustace, (2) does not plead that Man knew Eustace was violating the CEA by defrauding the Fund, as opposed to its investors, and (3) that Man had actual knowledge of Eustace's fraudulent activities or intended to promote those activities. (Def.'s Mot. 72-73.)

Plaintiff responds that the Complaint describes how the Offshore Fund received trading advice from Eustace for a fee and purchased or sold contracts for future delivery where Eustace manipulated the price of such contracts, which tracks the language of 7 U.S.C. § 25(a)(1)(A) and (D). Plaintiff further argues that there is no question that Eustace committed fraudulent acts in violation of the CEA because Eustace admitted as much. (Pl.'s Br. 62.) The Plaintiff also argues that the Complaint sufficiently alleges that (1) Man knew of Eustace's intent to violate the CEA, (2) Man intended to further those violations of the CEA, and (3) Man acted in furtherance of those violations.

In their Reply, with respect to the Plaintiff's aiding and abetting claim, Defendants argue that Plaintiff failed to allege that Eustace engaged in a primary violation of the CEA in light of the accurate account statements sent to the Fund's designated office and, more importantly, the Complaints fails to set forth that Man had actual knowledge of Eustace's alleged fraud. Instead, the allegations set out that Man should have known of those violations, which, according to Defendants, is not enough to state a claim under the CEA. (Def's Reply 48-50.)

The Complaint alleges that Man knew that Eustace's request to facilitate trades between the 10 and 50 Accounts constituted a securities violation (Compl. ¶¶ 58, 60), that Man knew Eustace was committing fraud in manipulating EFP trade dates (Compl. ¶¶ 35-26), and that Man knew, or should have known, that Eustace was committing fraud when it limited access to the 50 Account. In addition, the Complaint contains allegations that Man took affirmative steps to further those violations. (Compl. ¶¶ 32, 88, 45, 63 68.)

However, the Third Circuit's decision in Nicholas sets out a fairly high standard on the degree of knowledge that a plaintiff must allege in order to survive a motion to dismiss its CEA claims for aider and abetter liability. In that case, the court ruled that the district court properly dismissed the aiding and abetting claims brought by a group of investors against several futures commodities merchants for the FCMs' failure to supervise the activities of three traders. Nicholas, 224 F.3d at 189-90. The factual allegations contained in this Complaint are much stronger than those found in Nicholas. Accordingly, the Court finds that the allegations under Count VI are sufficient under a 12(b)(6) standard.

B. Fraud Claims

Concerning the common law fraud claims in the Complaint, which are brought against all Defendants, the Court has examined those under the principles of “particularity” as set forth in Federal Rule of Civil Procedure 9(b) and largely for the reasons stated above, finds that the allegations are sufficient. Although the allegations of the specific fraud claims, Counts VII and VIII, are themselves conclusory, they incorporate all the proceeding paragraphs, which allege a number of misrepresentations, which were material and knowingly made by Defendants. Plaintiff alleges that Man intended that UBS, the Offshore Fund and the other funds would rely on such misrepresentations, that they did in fact rely on those misrepresentations, and that they were injured as a result. (Compl. ¶¶ 144-46.)

Referring back to paragraph 38, quoted above, and also considering the allegations of backdating in paragraph 32, the Court finds that the particularity requirements have been met and will deny the Motion to Dismiss Counts VII and VIII.

C. RICO Claim

As to the RICO counts, the Court notes that as soon as it received notice of the filing of the RICO claim, it required the Plaintiff to file a “RICO Case Statement,” Doc. No. 4, filed May 26, 2006. The Plaintiff has supplemented this statement with a more thorough review of its RICO allegations in its brief. (Pl.’s Br. 20-40.)

Defendants’ first attack on the RICO claim is the failure to allege the existence of a cognizable RICO enterprise. Plaintiff alleges that the RICO enterprise is an association consisting of Man, the employee Defendants (i.e., the seven individual Defendants in this case), Eustace and PAAMCo. Defendants assert that the alleged association does not meet the

requisites of Seville Industrial Machinery Corp. v. Southwest Machine Corp., 742 F.2d 786 (3d Cir. 1984), and particularly that the allegations themselves show that the purported RICO enterprise is not separate from the alleged racketeering activity. (Defs.' Reply 23-28.)

The leading authority on this issue is the Supreme Court's opinion in Cedric Kushner Promotions Ltd. v. King, 533 U.S. 158 (2001), although not cited by any of the parties, where the Supreme Court for the first time definitively upheld the distinctiveness requirement between the RICO enterprise and the RICO defendants, an issue that had been debated vigorously in the lower courts. Justice Breyer, speaking for an unanimous court, held based on the language of the RICO statute that the plaintiff "must allege and prove the existence of two distinct entities: (1) a 'person' and (2) an 'enterprise' that is not simply the same 'person' referred to by a different name." Id. at 161. Although the court accepted the "distinctness" principle, it held that in that case where "the corporate owner/employee was a natural person, he is distinct from the corporation itself, a legally different entity with different rights and responsibilities due to its different legal status," and the statute did not require "more separateness" than that. Id., 533 U.S. at 163.

Thus, although distinctiveness is required, the Supreme Court indicated that as long as there is some, even "technical," distinctiveness between the RICO enterprise and the RICO defendants, that the requirements of the statute have been met.

In this case, the alleged RICO enterprise does include all of the Defendants, but adds Eustace and PAAMCo as members of the alleged RICO association. The Court finds that therefore this alleged RICO enterprise is satisfactory under the principles enunciated by the Supreme Court.

The Court has reviewed the other facts alleged in the Complaint and the RICO Case Statement and finds that Plaintiff has adequately pled the requisite predicate acts by Defendants Man and Gilmartin. These include allegations of back-dating by Gilmartin, including statements allegedly made to or by Gilmartin that he knew that his conduct and the conduct of Man for which he was responsible, as the principal broker handling the Offshore Fund account, was aiding the goals of the alleged RICO scheme. (Pl.'s RICO Case Statement §§ 1(b)(i)-(viii).)

However, the Court finds that the allegations against the other Man employees are insufficient to show that they were personally involved in the predicate acts alleged against Man and Gilmartin. Although the RICO Case Statement does make some general statements as to their responsibility, the Court believes, given the specifics of the RICO statute and the vastly increased exposure which a RICO defendant shoulders, including treble damages and attorneys fees, that Plaintiff was obliged, but failed, to allege, more specific involvement by the other six employee Defendants in the alleged scheme if they were to remain RICO defendants.

V. Deepening Insolvency

In Count X, Plaintiff brings a claim for deepening insolvency against Man and employee Defendants. As the parties recognize, the Third Circuit has indicated that this tort would likely be recognized by Pennsylvania law. See Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340 (3d Cir. 2001). Because the claim, as stated, incorporates all of the prior allegations, and in view of notice pleading, the Court will deny Defendants' Motion to Dismiss this claim and require that it be sorted out based on a full evidentiary record if Defendants wish to raise their contentions again on summary judgment.

VI. Conclusion

The Court will enter an Order denying Thomas Gilmartin's Motion to Dismiss in full and granting the other Defendants' Motion to Dismiss in part as to certain of the individual Defendants on the RICO claim, but otherwise denying the Motion to Dismiss.

An appropriate Order follows.

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

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| C. CLARK HODGSON, JR., RECEIVER | : | CIVIL ACTION |
| | : | |
| v. | : | |
| | : | |
| THOMAS GILMARTIN, et al. | : | NO. 06-1944 |

ORDER

AND NOW, this 5th day of October, 2006, based on the foregoing Memorandum, it is hereby ORDERED that the Motion to Dismiss the Complaint filed by Thomas Gilmartin (Doc. 44) is DENIED in full, and the Motion to Dismiss the Complaint filed by the other Defendants (Doc. No. 45) is GRANTED in part and DENIED in part.

BY THE COURT:

/s/ Michael M. Baylson
Michael M. Baylson, U.S.D.J.