JOHN V. REITZ, et al., Plaintiffs, v. LEASING CONSULTANTS ASSOCIATES, et al., Defendants. JOHN and JANICE GILBERTSON, et al., Plaintiffs, v. LEASING CONSULTANTS ASSOCIATES, et al., Defendants. ANTHONY E. CATALAN, Plaintiff, v. PAULSON INVESTMENT COMPANY, INC., et al., Defendants

Civil Nos. 86–1368–RE, 86–1369–RE, 87–593–RE

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

1988 U.S. Dist. LEXIS 17568

July 13, 1988, Decided

July 13, 1988, Filed

CASE SUMMARY

PROCEDURAL POSTURE: Plaintiff investors filed three actions against defendants, organizers of limited partnerships and associated entities, that were consolidated in which they alleged violations of *15 U.S.C.S. § 77*(q)(a), *15 U.S.C.S. § 78j*(b), Or. Rev. Stat. § 59.135, *18 U.S.C.S. § 1962*(c), (d), Or. Rev. Stat. § 165.720(3), (4), Or. Rev. Stat. § 166.720(4), and common law claims. Defendants filed a motion for summary judgment.

OVERVIEW: The investors, who purchased interests in seven limited partnerships engaged in a scheme to sell and lease computer hardware and software as tax shelters, filed actions after the tax shelters collapsed, alleging that they were induced to make the investments by misrepresentations made in the offering memoranda. Defendants filed motions for summary judgment arguing that the statutes of limitations barred the investors' claims. The court ruled (1) that all the federal claims and the state law claims except the claim under Or. Rev. Stat. § 165.720(3), (4) and Or. Rev. Stat. § 166.720(4) were barred by the relevant statutes of limitations because the investors were placed on inquiry notice of the possibility of fraud through periodic reports they received discussing the status and problems of the partnerships and because notice of the possibility of fraud to the general partners was imputed to them, and (2) that defendants did not fraudulently conceal the securities problems by lulling the investors into inaction through the periodic reports because those same reports disclosed the risks and placed the investors on inquiry notice of possible fraud.

OUTCOME: The court granted defendants' motion for summary judgment. The court declined to exercise pendent jurisdiction over the remaining claim under the Oregon Racketeer Influenced and Corrupt Organizations Act and dismissed it for want of subject matter jurisdiction.

COUNSEL:
[*1]

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JUDGES:
James A. Redden, United States District Judge.

OPINIONBY:
REDDEN

OPINION:

OPINION **[*3]**

These are three consolidated securities cases involving seven limited partnerships. Defendants move for summary judgment urging that the statutes of limitations bar plaintiffs' claims. I grant the motions.

BACKGROUND

I. Introduction

Plaintiffs seeking tax shelters invested in seven limited partnerships during the years 1979 through 1981. Tax problems arose, but plaintiffs did not then attempt to investigate their claims or file this action. When the tax shelters collapsed, plaintiffs paid no heed to their investments but instead sought to resolve their tax problems. Many plaintiffs became aware of the alleged securities claims only after attorneys for a potential defendant notified them of the possible claims in 1986. Plaintiffs, on the advice of counsel, waited several more months before filing. When plaintiffs settled with the Internal Revenue Service (IRS) they finally filed their complaints.

II. The Parties and the Structure of the Partnerships

These actions are identical for the purposes of these motions.

I noted in my June 17, 1987 Opinion that plaintiffs are limited partners in seven partnerships: Columbia Associates Limited Partnership (Columbia); Duval Associates **[*4]** Limited Partnership (Duval); Euston Associates Limited Partnership (Euston); Lamar Associates Limited Partnership (Lamar); Mt. Hood Associates Limited Partnership (Mt. Hood); Salem Associates Limited Partnership (Salem); and Troy Associates Limited Partnership (Troy). The actions involve several of the partnerships and sometimes different partners, and I refer to the plaintiffs by partnership.

Defendants are best identified by their various roles in the sales of partnerships and in operations of the partnerships themselves. The core defendants are those who organized and packaged the entire investment scheme. The packagers are: Leasing Consultants Associates (LCA); Leasing Consultants, Inc. (LCI); William McKenna; Richard A. Heitmeyer; Richard D. Wellbrock; and William Ward.

In addition to the core defendants, several groups of additional defendants are involved. Each partnership involved purchases of certain IBM computer equipment (the hardware); and the purchase of various types of software equipment (the software). The scheme had an immediate seller purchase the equipment from the equipment seller, following which the partnership would purchase the equipment from the immediate **[*5]** seller. Then the partnership would lease the equipment back to the equipment seller or the affiliated lessee. In the hardware transactions, the hardware seller and lessee were the same but in the software transactions the software seller was affiliated with the software lessee. These two groups of sellers/lessees form another group of defendants. The immediate group of sellers are Computer Systems Consultants, Inc. (Computer Systems), LCI, LCA and American Computer Equipment Leasing, Inc. (American Computer).

The hardware equipment sellers/lessees are: Analysis International Co., Inc. (Analysis); Alanthus Computer Corp. (Alanthus); Comdisco, Inc. (Comdisco); and Rockwood Computer Corp. (Rockwood). The software equipment sellers are: Rosen Associates (Rosen); Kirby Microprocessors, Inc. (KMI); M.A. Hanson & Associates (Hanson); Robrech Systems, Inc. (Robrech); Buhler Software Services (Buhler); ASG Program Products, Inc. (ASG); and Start System, Inc. (Start). The affiliated software lessees are: Software Systems for Word Processors, Inc. (SSWPI) affiliated with Rosen; Kirby Computer Systems, Inc. (Kirby Computer) with KMI; Prose, Inc. (Prose) with Hanson; Digitize, Inc. (Digitize) with **[*6]** Robrech; P–STAT, Inc. (P–Stat) with Buhler;

Applications Systems Group, Inc. (Applications) with ASG; and Jeflen Consulting Corp. (Jeflen) with Start.

The remaining defendants are the equipment appraisers who evaluated the equipment and the attorneys who helped organize the partnerships and provided legal advice including a tax opinion. The hardware appraisers are Computer Value Associates (Value); Berlent Industries, Inc. (Berlent); TexCom Equipment Corp. (Texcom); and Global Computer Corp. (Global). The software appraisers are Technical Marketing Services, Inc. (TMS); Ward; Edward Fizell; ConServ International, Inc. (ConServ); and Information Industries, Inc. (Information). The attorneys are Lampf, Pleva, Lipkind, Prupis & Petigrow, P.C., and Arnheim & McCostis.

In addition to these, other defendants include affiliated entities and controlling persons of some of the above-mentioned entities. I need not develop the roles of these defendants. A more detailed analysis of the parties and their roles is set forth in my June 17, 1987 Opinion.

Although the sales of the equipment were the same, the marketing of the equipment differed. Because the hardware was already in use at the time of **[*7]** the purchase, the hardware lessee did not have to find a sublessor for the equipment. The software, however, was novel. It had not been marketed and licensed prior to sale. The success of the software was key to the success of the limited partnerships. Each partnership targeted a different market and the software determined that market.

III. The Sale and Operation of the Partnerships

Plaintiffs purchased interests in the partnerships during the years 1979 through 1981. Plaintiffs allege that the packagers prepared investment memoranda for the partnership offerings and that they relied on these memoranda in making their investments. The memoranda contained statements involving the risk of investment, appraisals of the equipment and tax opinions.

General partners controlled each partnership. Roger Nelson and James Quenemoen controlled Duval and Troy; Richard Anderson controlled Lamar; Michael Welwood, Frank Leahy and Quenemoen controlled Mt. Hood; Robert Williams and Quenemoen controlled Columbia and Euston; J. Richard Hurst controlled Salem, and Nelson controlled Troy. Each partnership retained consultants. William Ward ultimately served as consultant for all.

Ward rendered his services **[*8]** through the Lawrence Group, Inc. Periodically, Ward provided the general partners with reports which discussed the status and problems of each partnership (the Lawrence Reports). According to defendants, the general partners sent these reports to the limited partners including plaintiffs.

IV. The Problems

The partnerships had trouble early on because of several factors, including technological obsolescence. Plaintiffs received reports that the software sales were dismal and the hardware's value was rapidly declining. With the possible exception of those in Lamar, plaintiffs received reports in late 1982 and early 1983 recommending a change in the character of the investments. In 1983, Mt. Hood sold its software back to the seller and invested the proceeds in commercial real estate.

In late 1982 and early 1983, plaintiffs received notice that the IRS was investigating the partnerships. The law firm of Hagen & Dye represented most of the partnerships before the IRS.

Paulson Investment Co., which sold some of the partnership interests, sensed potential liability and retained the law firm of Stoll & Stoll. In mid–1986, the Stoll firm advised Paulson of significant liability exposure **[*9]** and suggested a way to elminate that exposure. Paulson would fund plaintiffs lawsuit in exchange for plaintiffs' promises not to sue Paulson. In a "Dear Investor" letter, the Stoll firm advised plaintiffs it would file the lawsuit two months after the IRS's offer of settlement. The IRS settlement offer was dated November 13, 1986. The Reitz and Gilbertson plaintiffs accepted Paulson's offer and filed December 5, 1986.

Plaintiff Catalan declined Paulson's offer and filed an independent action in early June 1987, against Paulson and the defendants named in the other two cases. On January 5, 1988, Catalan agreed to dismiss Paulson with prejudice. Paulson, however, remains a third party defendant by virtue of a claim against it for indemnity and contribution. My Opinion of August 13, 1987 discusses this in greater detail.

V. The Allegations and the Record

The fourth amended complaints (the complaints) allege that plaintiffs were induced to make the investments by several misrepresentations in the offering memoranda. Those misrepresentations are that the investments would entitle plaintiffs to substantial tax benefits; that the leasing of the hardware/software packages would **[*10]** generate a profit; that the software was readily marketable; and that the equipment appraisals were reasonable and accurate. Plaintiffs allege that subsequent investigations revealed that these representations were false.

The complaints allege seven claims for the sales of the seven partnerships. Each claim contends the traditional several counts. Plaintiffs allege (1) violations of section 17(a)(1) of the Securities Act of 1933, *15 U.S.C.*

§ 77(q)(a); (2) violations of section 10b of the Securities Exchange Act of 1934, *15 U.S.C. § 78j*(b); (3) violations of Oregon securities laws, O.R.S. 59.135; (4) violations of federal *RICO, 18* U.S.C. § 1962(c) and (d); (5) violations of the Oregon RICO statute, O.R.S. 165.720(3) and (4), O.R.S. 166.720(4); and (6) several common law claims for fraud, negligence and negligent misrepresentation against various defendants.

STANDARDS

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). The materiality **[*11]** of a fact is determined by the substantive law on the issue. *T.W. Electrical Service v. Pacific Electrical Contractors Ass'n, 809 F.2d 626, 630 (9th Cir. 1987).* The authenticity of a dispute is determined by whether the evidence is such that a reasonable party could return a verdict for the nonmoving party. *Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986).*

The moving party has the burden of establishing the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986).* If the moving party shows the absence of a genuine issue of material fact, then the nonmoving party must go beyond the pleadings and identify facts which show a genuine issue for trial. *Celotex, 477 U.S. at 324.*

Special rules of construction apply to evaluating summary judgment motions: (1) all reasonable doubts as to the existence of genuine issues of material fact should be resolved against the moving party; and (2) all inferences to be drawn from the underlying facts must be viewed in the light most favorable to the nonmoving party. *T.W. Electrical, 809 F.2d at 630.*

DISCUSSION
[*12]

I. Introduction

Defendants move against the claim under section 17(a) and I grant the motion to dismiss. *In re Washington Public Power Supply System Securities Litigation, 823 F.2d 1349, 1358 (9th Cir. 1987).*

I later discuss defendants' motion against the pending state claims and grant it.

As to the statute of limitations issue, defendants argue that plaintiffs were on inquiry notice. Defendants say plaintiffs had direct knowledge of possible fraud with the receipt of the Lawrence Reports outlining the partnerships' dismal performance, and that plaintiffs knew of possible fraud by imputation, due to the knowledge of the general directors.

Plaintiffs challenge both of these contentions. As to the Lawrence Reports, plaintiffs argue that defendants have not shown their receipt of the reports, and further that even if they received same, the reports would not have put a reasonable investor on notice. Plaintiffs also contend that even if they were on inquiry notice, defendants fraudulently concealed the relevant information from them. As to the knowledge by imputation, plaintiffs argue that the general partners exercised due diligence but failed to discover the fraud. **[*13]** Again, plaintiffs invoke the doctrine of fraudulent concealment.

II. The Statute of Limitations

A. Standards

The federal securities claims are subject to Oregon's two year statute of limitations for fraud, O.R.S. 12.110(1). *Robuck v. Dean Witter & Co., 649 F.2d 641, 643 (9th Cir. 1980).* The limitations period for the federal RICO claims is four years. *Agency Holding Corp. v. Massey–Duff & Assoc., Inc., U.S. , 107 S. Ct. 2759 (1987).* There is a three year statute of limitations on the state securities claim, O.R.S. 59–115(b)(5) (1983) as well as on the common law claims, O.R.S. 12.110(1). A five year statute of limitations applies to the Oregon RICO claims, O.R.S. 166.725(11) (ORICO). If the statute of limitations bars the federal claims, including RICO, it will also bar all of the state claims except ORICO.

Federal law controls the point at which the statute of limitations commences to run for these federal claims. *Volk v. D.A. Davidson, 816 F.2d 1406, 1412, 1415 (9th Cir. 1987).* Normally, the period commences at the time of injury; for instance, in cases involving securities fraud, the investor suffers injury when **[*14]** he enters into a transaction as a result of a material misrepresentation. Id. at 1912. However, the statute of limitations is not triggered until the defrauded individual has actual or inquiry notice. That is, the statute begins to run when plaintiff in the exercise of due diligence discovered or should have discovered the facts of which he complains. Id. See *Maggio v. Gerard Freezer & Ice Co., 824 F.2d 123, 129 (1st Cir. 1987)* (noting that the statute commences when the investor should have known of the possibility of fraud).

As to inquiry notice, knowledge of all the facts is not necessary to commence the limitations period. See *Meadows v. Bicrodyne Corp., 785 F.2d 670, 672 (9th Cir. 1986).* The clock begins to run when a plaintiff senses "storm warnings", *Cook v. Avien, Inc., 573 F.2d 685, 696 (1st Cir. 1978),* not when he hears thunder and sees lightening. *Jensen v. Snelling, 636 F. Supp. 1305, 1309 (E.D.*

La. 1986). A plaintiff is on inquiry notice if he possesses such knowledge as would alert a reasonable investor to the possibility of fraud. *Maggio, 824 F.2d at 128.*

B. Direct **[*15]** Knowledge: the Lawrence Reports

1. Individual Receipt of the Lawrence Reports

Plaintiffs would create a factual dispute regarding their receipt of the Lawrence Reports. They contend that defendants have failed to authenticate the reports or show the relevance of them. Plaintiffs, however, produced the reports and concede receipt by alleging that these reports lulled them into inaction. Defendants have shown that the Lawrence Reports were sent with the periodic reports from the general partners. There is no genuine issue of material fact as to plaintiffs' receipt of the Lawrence Reports.

2. The Contents of the Reports

The Lawrence Reports showed that although the investment memoranda projected significant sales, the partnerships showed no sales. These dismal reports continued until 1982, when Ward recommended considering other options. Most of the partnerships considered return of the software during 1982, but only Mt. Hood opted for return and reinvestment in real estate.

The Mt. Hood plaintiffs whose partnership closed on September 29, 1980, received a June 29, 1981 report indicating no software sales; a November 14, 1981 report indicating that of 140 projected sales, none had been **[*16]** made, and the marketing effort was very poor. They also received a May 17, 1982 report stating that the software marketing was unsuccessful and urging other options, as well as a June 6, 1983 report indicating that the value of the hardware was declining sharply.

The Salem partnership experienced similar difficulties. As early as December 1981, the software required re–programming to run on different hardware. During the same period, the sales of the software licenses were at a standstill, and by July 1982, the required re–programming was not yet complete. It was reported that re–programming was not worthwhile, and that there were no current sales.

The Lamar partnership suffered a similar plight. In his appraisal, Ward indicated that eight hundred software licenses would be sold in the first three years. Anderson, the general partner, indicated in 1981 that only one license had sold. Anderson also reported that the software needed revision which could cost as much as $50,000. He also reported new loans to Robrech and Digitize. Finally in October 1982, Anderson reported that only three licenses had been sold.

The remaining partnerships experienced similar difficulties. The reports **[*17]** of the general partners, as well as the Lawrence Reports indicated that the software licenses were not selling and the software required re–programming. These problems with the all–important software sales should have given notice to a reasonable investor that something was amiss.

In addition to these reports, plaintiffs also received reports that the hardware was declining sharply in value. Plaintiffs also received information that the rental income from the hardware had been deferred or was unpaid.

3. Conclusion

I find that the Lawrence Reports would have placed a reasonable investor on notice of the possibility of fraud as early as the fall of 1982. Plaintiffs contend that they exercised due diligence by relying on the reports of the general partners and on the Lawrence Reports. Plaintiffs argue that these reports were consistent with the offering memoranda and contained no specifics as to the facts underlying their claims. They also contend that defendants fraudulently concealed the true scope of the problems through these reports. These arguments are not supported by the record or the law.

If the contents of the reports were consistent with the offering memoranda, then the offering **[*18]** memoranda put plaintiffs on sufficient notice of the possibility of fraud. The reports need not contain the details of the fraud to trigger inquiry notice but need only put plaintiffs on notice of the possibility of fraud, e.g., their investment was worth less at investment time than they actually paid for it.

I find that the Lawrence Reports put plaintiffs on inquiry notice of the possibility of fraud. The reports did not conceal their claims.

C. Notice by Imputation

1. Introduction

In addition to the Lawrence Reports, the general partners had access to other sources of information such as reports from their attorneys and the allegations of an offeree representative, George Poggel. Defendants argue that such knowledge constituted notice of the possibility of fraud and should be imputed to plaintiffs.

The limited partnerships were Connecticut corporations and the interests were sold in Oregon. Both Oregon and Connecticut recognize that notice to or knowledge of the general partners regarding matters relating to the partnership operate as notice to or knowledge of the partnership. O.R.S. 68.240; Conn. Gen. Stat. §§ 34–50. Both states also recognize that fraud on the partnership committed **[*19]** by or with the consent of the partner bars imputation. O.R.S. 68.240; Conn. Gen. Stat. §§ 34-50. There is no conflict of laws problem, and I apply the law of the forum, Oregon. See *Klaxon v. Stentor Electric Manufacturing Co., 313 U.S. 487 (1941).*

Defendants point out that the general partners knew of the problems in early 1982, and focus their discussions on Quenemoen who was a general partner of or connected to all of the partnerships save Lamar. Plaintiffs do not suggest that Anderson, Lamar's general partner, had no such notice. Anderson advised the limited partners of the poor sales as early as 1981, and of the IRS audit in October 1982. Defendants also point out that several other events put the general partners on notice of the possibility of fraud.

Plaintiffs argue that the general partners exercised due diligence and discovered no fraud. They also argue that the general partners were part of or consented to the fraud.

2. The General Partner's Knowledge

a. The Burt Report

In July 1982, Mt. Hood retained attorney Robert Burt to represent them in the IRS investigation. Burt's investigation led him to believe that defendant LCI might be liable by reason of **[*20]** misrepresentation, fraud, negligence and breach of contract. Although defendants indicate that most of Burt's discussions were with Welwood, Burt indicated that all of Mt. Hood's general partners, including Quenemoen, decided not to pursue these claims for business reasons. Defendants argue that Quenemoen's knowledge acquired in the Mt. Hood investigation should be imputed to the other partnerships in which he participated.

b. The Poggel Allegations

To effect the Mt. Hood change in investments, Burt prepared an extensive information packet which explained the exchange. George Poggel, the offeree representative for plaintiff Marchette, responded to the packet alleging possible fraud, conflicts of interest and possible criminal violations. Burt had an associate, Dana Taylor, investigate the allegations. According to Taylor his investigation was limited to a possible conflict of interest. The result of the Taylor investigation were negotiations in 1982 over a proposed indemnity agreement between defendants LCI, LCA, Hamilton Resources and McKenna, and the Mt. Hood partnership. Ultimately, the parties reached a narrower agreement. However, defendants contend that the fact that the general **[*21]** partners attempted to secure such an agreement indicates that they feared securities claims.

3. Conclusion

I find that both sources, as well as the Lawrence Reports, put the general partners on inquiry notice of the possibility of fraud. Indeed, Burt suggested this possibility. Further, the very reports of the general partners indicated that the investments had significant problems and might not be worth as much as plaintiffs paid for them.

Plaintiffs contend that the general partners exercised due diligence and did not discover the facts underlying their claims. As to the Burt report, plaintiffs contend that he never performed any factual investigation to determine or substantiate the possible liability. However, as noted above, Burt suspected the possibility of fraud, and this knowledge is sufficient for inquiry notice.

Further, as to the Poggel allegations, plaintiffs contend that Taylor's investigation satisfied the due diligence requirement. According to plaintiffs, Poggel only complained of a possible conflict of interest and Taylor's investigation was limited to this issue. However, as noted above, the Poggel allegations went beyond a conflict problem and also raised the possibility **[*22]** of fraud.

III. Fraudulent Concealment

A defendant's conduct may serve to toll the statute of limitations if it is established that the defendant intentionally concealed the fraud. *Volk, 816 F.2d at 1415, 1416.* To establish fraudulent concealment, plaintiff must demonstrate affirmative conduct on the defendant's part which, under the circumstances, would lead a reasonable person to believe that he did not have a claim. Id.

Plaintiffs contend that defendants fraudulently concealed the securities problems in two ways: (1) the Lawrence Reports lulled plaintiffs into inaction; and (2) LCI installed Quenemoen as general partner. Plaintiffs contend that the Lawrence Reports were consistent with the risks disclosed in the various offering memoranda, and point out that the reports were not entirely negative.

However, this argument cuts two ways. If the investment memoranda disclosed the risks, then plaintiffs were on notice at the time of purchase. If investment memoranda contain conflicting data on the investment, plaintiffs cannot choose the positive without taking into account, i.e., being on notice, of the negative. *Kennedy v. Josephthal & Co., Inc., 814 F.2d 798 (1st Cir. 1987).* **[*23]**

Further, as noted above, I find that the Lawrence Reports put plaintiffs on inquiry notice. If these reports and those of the general partners put plaintiffs on inquiry notice, then the same reports could not have concealed the fraud.

Plaintiffs say Quenemoen was a former LCI employee and that he was installed as general partner by LCI. They offer nothing to suggest that the prior association was improper or that Quenemoen was actively engaged in the fraud or consented to it. Even if Quenemoen consented to the fraud, his knowledge may be imputed for the sake of third parties not participating in the fraud. *Armstrong v. Ashley, 204 U.S. 272 (1907).*

IV. Conclusion

I find that plaintiffs were on inquiry notice, either directly or indirectly, of the possibility of fraud as early as October 1982. The Reitz and Gilbertson plaintiffs filed in December 1986. Catalan filed in June 1987. Therefore, all the federal claims are barred by the relevant statutes of limitations.

Only the ORICO claim remains. I decline to exercise pendent jurisdiction over this state claim, and I dismiss it for want of subject matter jurisdiction.

I grant defendants' motions for summary **[*24]** judgment.