

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

DOROTHY H. NICKEL,

Plaintiff,

v.

MEMORANDUM AND ORDER
06-C-24-S

NEVIN J. GILLETTE and DIVERSIFIED
FINANCIAL OF ILLINOIS, INC.,

Defendants

Plaintiff Dorothy Nickel commenced this action for fraud, breach of fiduciary duty and violation of the Racketeer Influenced and Corrupt Organizations Act (RICO) against her investment advisors and brokers, defendants Nevin Gillette and Diversified Financial of Illinois, Inc. Jurisdiction is alleged pursuant to 28 U.S.C. § 1331 based on federal securities fraud and RICO claims. The matter is presently before the Court on defendants' motion to dismiss for failure to state a claim and for lack of subject matter jurisdiction. The following is a summary of the allegations of the complaint.

FACTS

Plaintiff is a Wisconsin resident and an unsophisticated investor. Defendant Gillette is an Illinois investment advisor and broker and an agent of defendant Diversified. In 1985 defendants

made representations to plaintiff and her husband and solicited them to open an account with defendants for the purpose of purchasing securities and life insurance. Plaintiff and her husband opened an account and invested funds, relying on defendants to make investment decisions on their behalf. Defendants made the following representations to plaintiff and her husband: that defendants would invest to preserve principal, maximize return and maintain liquidity; that defendants were experienced, knowledgeable investment advisors; that plaintiff and her husband would profit from the investments; that plaintiff's risk exposure would be limited.

Thereafter defendants received funds from plaintiff. According to a quarterly report dated October 1, 2005 and prepared by defendants plaintiff deposited a total of \$254,000 and the total value of the account was \$354,730. Although plaintiff has requested documentation of the investments held on her behalf, defendants have provided incomplete and inadequate documentation or explanations of investments. Defendants have failed to properly manage the accounts so that plaintiff has lost income and value in the account.

MEMORANDUM

Defendants seek to dismiss the complain on the basis that the allegations are insufficient to state federal claims for security

fraud or RICO and that there is no jurisdiction over the pending state law claims. Plaintiff argues that the motion to dismiss is procedurally improper, that the complaint adequately states the claims and that federal diversity jurisdiction exists even if the federal claims are dismissed.

A complaint should be dismissed for failure to state a claim only if it appears beyond a reasonable doubt that the plaintiffs can prove no set of facts in support of the claim which would entitle the plaintiffs to relief. Conley v. Gibson, 355 U.S. 41, 45-46 (1957). In order to survive a challenge under Rule 12(b) (6) a complaint "must contain either direct or inferential allegations respecting all the material elements necessary to sustain recovery under some viable legal theory." Car Carriers, Inc. v. Ford Motor Co., 745 F. 2d 1101, 1106 (7th Cir. 1984).

Procedurally, plaintiff objects that rather than file an independent brief in support of their motion defendants adopted the brief filed by defendant Protective Life Insurance Company, now dismissed from the case. There is no merit to the objection. Defendants were free to join in the brief of their co-defendant and plaintiff was not prejudiced by their joining. To the extent any arguments advanced by Protective Life were unique to it, they can readily be disregarded.

Securities Fraud

A Rule 10b-5 securities fraud claim includes six elements: (1) a misstatement or omission, (2) of material fact, (3) with scienter, (4) in connection with the purchase or sale of securities, (5) upon which plaintiff relied, and (6) that reliance proximately caused plaintiff's injuries. In re HealthCare Compare Corp. Securities Litigation, 75 F.3d 276 (7th Cir. 1996). The pleading threshold for a federal securities fraud action has been heightened, even beyond the particularity requirement of Rule 9(b), by the provisions of the Private Securities Litigation Reform Act. In an action based on a material misstatement or omission, "the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1). In addition, concerning allegations of scienter the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2).

Defendants challenge the sufficiency of the allegations of misrepresentation with scienter and a misrepresentation "in connection with the purchase or sale" of a security. In order to satisfy that "in connection with" element plaintiff must allege a

causal connection between misrepresentation and a securities transaction. S.E.C. v. Jakubowski, 150 F.3d 675, 680 (7th Cir. 1998). The essence of plaintiff's allegations are that defendants gave plaintiff statements concerning investments but were unable to verify that the securities listed on the statements were actually purchased. In response to the motion to dismiss plaintiff summarizes the allegations as follows: "It is alleged that, therefore, these defendants listed claimed Nickel investments and assets of some \$345,000, almost all of which there was no evidence to verify that they even existed." Fraud that involves not purchasing a security is not fraud in connection with a securities transaction because in such circumstances no sale or purchase occurs. There are no allegations that defendants made any misrepresentation concerning a security that was purchased on plaintiff's behalf. If defendants committed fraud, it is because they represented that they made investments which they in fact never made. That is not fraud in connection with the purchase or sale of securities. Accordingly, the allegations do not state a Rule 10-b claim.

RICO

Although the complaint does not specify the RICO provision under which it seeks relief, the only description of a claim appears to be the pursuit of one under 18 U.S.C. § 1962(c):

45. The Defendants associated with each other and conducted and participated, directly and indirectly, in the conduct of the enterprises of the Defendant Nevin Gillettte and the Defendant Diversified Financial, Inc., and did unlawfully derive income ... by the commission of acts of fraud....

Section 1962(c) provides as follows:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

To state a claim under § 1962(c) plaintiff must allege four elements: "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." Goren v. New Vison Intern., Inc., 156 F.3d 721, 727 (7th Cir. 1998). It is not enough for a plaintiff to allege the elements in boilerplate fashion; she must allege facts to support each element. Id.

The complaint fails to adequately allege the enterprise element. RICO enterprise must be "an ongoing 'structure' of persons associated through time, joined in purpose, and organized in a manner amenable to hierarchical or consensual decision making." Richmond v. Mationwide Cassel L.P., 52 F.3d 640, 644 (7th Cir. 1995). The "person" and the "enterprise" must be distinct entities and an enterprise cannot consist of a combination of a corporation plus its employees. Baker v. IPB, Inc., 357 F.3d 685,

691-92 (7th Cir. 2004). Accordingly, no claim is stated by alleging that defendants operate themselves, or that each operates a combination of both.

Were Diversified not a defendant the complaint might conceivably be construed to allege that Diversified was the enterprise and Gillette the person operating it. However, the allegations of the complaint are that Diversified is owned and operated by Gillette, thus belying the inference that there is some distinct structure of persons "organized in a manner amenable to hierarchical or consensual decision making." If there is some other enterprise operated by these defendants it is certainly not sufficiently identified in the complaint. Having failed to sufficiently allege an enterprise distinct from the defendants, plaintiff's RICO claim must be dismissed.

State Law Claims

The original Protective Life motion to dismiss made arguments to dismiss the state law claims based on arguments specific to Protective Life. Accordingly, that portion of the motion does not apply to defendants Diversified and Gillette. Apparently recognizing this, defendants argue only that the claims should be dismissed for lack of continuing subject matter jurisdiction. Specifically, that there is no longer a basis for federal question jurisdiction and the complaint fails to adequately allege the

\$75,000 jurisdictional amount in controversy to sustain jurisdiction on the basis of diversity of citizenship, 28 U.S.C. § 1332.

As the proponent of jurisdiction, plaintiff bears the burden to demonstrate a sufficient amount in controversy. However, the amount claimed in the complaint controls if made in apparent good faith unless it appears "to a legal certainty that the claim is really for less than the jurisdictional amount." Meridian Security Ins. Co. v. Sadowski, 441 F.3d 536, 541 (7th Cir. 2006). The complaint generally alleges damages "in excess of \$10,000" and viewing the complaint as a whole and particularly considering page two of exhibit D to the complaint, plaintiff alleges that she deposited in excess of \$250,000 with defendants. The complaint further alleges that defendants refused or were unable to verify that any significant assets are held in plaintiff's account. Accordingly, the alleged amount in controversy greatly exceeds the jurisdictional amount. It surely could not be said to a legal certainty that the amount in controversy was less than \$75,000.

Defendants contend that remand is required because after this motion was filed and briefed they voluntarily paid money to plaintiffs. However, such a payment has no impact on the jurisdictional question because "jurisdiction depends on the state of affairs when the case begins; what happens later is irrelevant." Gardynski-Leschuck v. Ford Motor Co., 142 F.3d 955, 958 (7th Cir.

1998). Accordingly, diversity jurisdiction exists over whatever state law claims remain against the defendants.

ORDER

IT IS ORDERED that defendants' motion to dismiss is GRANTED as it concerns plaintiff's federal securities law and RICO claims and is in all other respects DENIED.

Entered this 31st day of May, 2006.

BY THE COURT:

S/ _____

JOHN C. SHABAZ
District Judge