2010 WL 11273545 (Or.Cir.) (Trial Motion, Memorandum and Affidavit)
Circuit Court of Oregon.
Clackamas County

Tyrone Cruze SR. And Jacqueline Cruze, Trustees of the Tyrone Cruze Sr. And Jacqueline Cruze Family Trust Agreement Dated March 6, 1987, and California National Bank Custodian Fbo Tyrone Cruze IRA Acct Cct 0300 and Custodian Fbo Jacqueline Cruze IRA Acct Ccj0150, Plaintiffs,

v.

Martin L. HUDLER, an individual; Charles R. Markley, an individual; and Covenant Partners, LLC, a Nevada limited liability company, Defendants.

No. CV08090688.
January 29, 2010.

Oral Argument Requested

Defendant Hudler's Motion for Summary Judgment

Jay R. Chock, OSB No. 830043, e-mail: jchock@dunncarney.com, Irene A. Scruggs, OSB No. 065030, e-mail: iscruggs@dunncarney.com, Dunn Carney Allen Higgins & Tongue LLP, for defendant Hudler Trial Attorney: Jay R. Chock.

TABLE OF CONTENTS

REQUEST FOR ORAL ARGUMENT I
MOTION I
SUMMARY OF FACTS 1
POINTS AND AUTHORITIES 2
SUMMARY JUDGMENT STANDARD 2
FRAUD 3
Plaintiffs cannot establish that Hudler's alleged representations that he was a real estate developer and owned a legitimate real estate development business were false 4
Plaintiffs had no right to rely on Hudler's representations 4, 6, 7 and 8 7
Buyer has a duty to investigate seller's representations 8
Plaintiffs were sophisticated buyers 10
Plaintiffs conducted no investigation into Hudler's representations regarding Bridgeport's expenses [representations 6 and 8] 12
Hudler's representation that he and his wife were worth more than $30 million [representation 4] was not a material factor in Plaintiffs' decision to invest in Covenant. In addition, Plaintiffs had no right to rely on Hudler's financial statement 15
Plaintiffs knew that their security interest on the westerly 40 acres of the Keystone property was subject to Regal's right to receive 9.75 acres of that parcel free and clear and had no right to rely on Hudler's alleged representation otherwise [representation 7]. 17
SECURITIES FRAUD 19
Definition of "security" under Oregon law 20
Plaintiffs cannot satisfy the fourth element of the Pratt test because they had control over their investment; therefore, their interest in Covenant Partners, LLC does not qualify as a "security." 21
ELDER ABUSE: 26
Hudler Did Not "Take or Appropriate" Plaintiffs' Money or Property 27
Hudler's Involvement with Plaintiffs' Investment in Covenant was not "Wrongful." 29
DERIVATIVE CLAIM FOR BREACH OF FIDUCIARY DUTY: 31
Plaintiffs' derivative claim fails as a matter of law because they admittedly failed to make a pre-litigation demand on Bridgeport communities 31
Plaintiffs' theory of joint liability does not save their derivative claim because they failed to

allege any wrongful conduct by Hudler that would trigger the Granewich rule. 33
CONCLUSION 36

TABLE OF AUTHORITIES

CASES

Baker v. Casey, 166 Or 433 (1941) 9, 10
Church v. Woods, 190 Or App 112 (2003) 27, 28, 30
Classic Instruments, Inc. v. VDO-Argo Instruments, Inc., 73 Or App 732 (1985) 3
Computer Concepts, Inc. v. Brandt, 310 Or 706 (1990) 21
Coy v. Starling, 53 Or App 76 (1981) 10, 14
Creditors Protective Assn. v. Balcom, 248 Or 38 (1967) 35
Custom Chrome, Inc. v. CIR, 217 F3d 1117 (9th Cir 2000) 12
Custom Chrome, Inc. v. Commissioner, 76 TCM (CCH) 386 (1998), aff'*d in part, rev'd in part,* 217 F3d 1117 (9th Cir 2000) . 11
Granewich v. Harding, 329 Or 47 (1999) 34, 35, 36
Grant v. Cartozian Bros., 120 Or 607 (1927) 8
Great Lakes Chem. Corp. v. Monsanto Co., 96 F Supp 2d 376 (D Del 2000) 2, 23, 24
Hall v. Fitzhugh, 80 Or App 423 (1986) 9
Held v. Product Mfg. Co., 286 Or 67, 592 P2d 1005 (1979) 20
Heverly v. Kirkendall, 257 Or 232 (1970) 17
Horner v. Wagy, 173 Or 441 (1944) 7
Housley v. Linnton Plywood Ass 'n, 210 Or 520 (1957) 16
Howard v. Merrick, 145 Or 573 (1933) 8
Jones v. General Motors Corp., 325 Or 404 (1997) 3
Kamen v. Kemper Fin. Servs., 500 US 90 (1991) 32
Keith v. Black Diamond Advisors, Inc., 48 F Supp 2d 326 (S D NY 1999) 23, 24
Miller v. Protrka, 193 Or 585 (1951) 8, 9, 10, 11, 16
Musgrave v. Lucas, 193 Or 401 (1971) 4, 16, 18
Nelson v. Sierra Const. Corp., 77 Nev 334, 364 P 2d 402 (1961) . 33
Noakes v. Schoenborn, 116 Or App 464 (1992) 32
OPERB v. Simat, Helliesen & Eichner, 191 Or App 408 (2004) .. 4, 9
Palmberg v. City of Astoria, 112 Or 353 (1924) 4, 17, 18
Pelton v. Gold Hill Canal Co., 72 Or 353 (1914) 35, 36, 37
Pratt v. Kross, 276 Or 483 (1976) 21, 22, 23, 27
Robinson v. Glynn, 349 F3d 166 (4th Cir 2003) 22, 24
S.E.C. v. W. J. Howey Co., 328 US 293 (1946) 21
Seeborg v. General Motors Corp., 284 Or 695 (1978) 3
Shoen v. SAC Holding Corp., 122 Nev 621, 137 P 3d 1171 (2006) 32, 33, 34
U.S. National Bank v. Fought, 291 Or 201 (1981) 8
United Housing Found., Inc. v. Forman, 421 US 837 (1975) 21
Vasquez-Lopez v. Beneficial Oregon Inc., 210 Or App 553 (2007) 10, 11
Womer v. Melody Woods Homes Corp., 165 Or App 554 (2000) . 8

STATUTES

NRS 41.520(2) 34
NRS 86.483 33
NRS 86.487 33
ORS 59.015 21
ORS 59.115 20
ORS 59.135 20
ORS 59.137 20
ORS 63.165(1) 35, 37
ORS 124.100 1,28

1 ORS 164.015(1) 29
OTHER AUTHORITIES
Black's Law Dictionary 93 (5 th ed 1979) 29
Black's Law Dictionary 811(5 th ed 1979) 7
Black's Law Dictionary 1303 (5 th ed 1979) 29
ORCP 47 .... 1, 3
ORCP 47 C 3
UTCR 5.050 1

REQUEST FOR ORAL ARGUMENT

Pursuant to UTCR 5.050, Defendant Martin L. Hudler (hereinafter referred to as "Hudler") requests oral argument on this motion. It is estimated that 120 minutes will be needed for the hearing. Official court reporting services are requested.

MOTION

Pursuant to ORCP 47, Hudler moves the Court for an Order granting summary judgment or partial summary judgment with respect to Plaintiffs' claims against him for (1) common law fraud; (2) violation of the Oregon Securities Act; (3) financial **abuse** of a vulnerable person; and (4) breach of fiduciary duty.

First, partial summary judgment is appropriate on Plaintiffs' fraud claim because Plaintiffs cannot prove all elements of fraud as to some of Hudler's alleged representations.

Second, summary judgment is appropriate on Plaintiffs' claim for violation of the Oregon Securities Act because Plaintiffs' interest in Covenant Partners, LLC is not a security.

Third, summary judgment is appropriate on Plaintiffs' **elder** **abuse** claim because Plaintiffs cannot prove all elements of the claim by the preponderance of the evidence. Specifically, Plaintiffs cannot establish that (1) Hudler "took or appropriated" Plaintiffs' money or property within the meaning of ORS 124.100; or that (2) the taking or appropriation of Plaintiffs' money or property, if any, was "wrongful" within the meaning of ORS 124.100.

Fourth, summary judgment is appropriate on Plaintiffs' derivative claim for breach of fiduciary duty because (1) Plaintiffs failed to make a pre-litigation demand on Bridgeport Communities, LLC, the managing member of Covenant Partners, LLC; and (2) Hudler cannot be held personally liable for the allegedly tortious conduct of Bridgeport Communities, LLC.

This motion is supported by the court file and the documents contained therein, the Declaration of Martin L. Hudler (hereinafter "Hudler Dec."), the Affidavit of Irene A. Scruggs (hereinafter "Scruggs Aff.") along with the exhibits attached thereto, and the following points and authorities.

SUMMARY OF FACTS

In a nutshell, Plaintiffs allege that Defendants fraudulently and illegally caused them to invest money in an unprofitable real estate venture. Amended Complaint (hereinafter "Complaint") ¶¶1-36.

Bridgeport Communities, LLC (hereinafter "Bridgeport") is an Oregon entity engaged in the business of real estate development. See Hudler Dec. ¶ 5. At all material times, Hudler and Markey were the sole members and managers of Bridgeport. Complaint ¶6. In 2007, Plaintiffs partnered with Bridgeport to develop various properties they owned. Complaint ¶¶2, 17. To do so, Plaintiffs and Bridgeport formed JTB Equities, 1000-4000, LLC. Complaint ¶117; see Hudler Dec. ¶ 7. Plaintiffs make no claims and allege no damages as a result of that joint venture.

WestlawNext © 2016 Thomson Reuters. No claim to original U.S. Government Works.

Instead, Plaintiffs' lawsuit arises out of another joint venture with Bridgeport. Bridgeport was the sole member and manager of Covenant Partners, LLC (hereinafter "Covenant"), a Nevada entity. Complaint ¶¶14, 11. Covenant had been working on developing a 105-acre piece of property in Reno, Nevada, commonly known as the Keystone Community Campus or the Keystone Canyon Planned Unit Development (hereinafter "the Keystone property"). Complaint ¶¶8-11. The Keystone property was owned the Keystone Community Corporation (hereinafter "Keystone"). Complaint ¶11 For the purpose of developing the Keystone property, Regal Pointe, Inc., a subsidiary of Keystone, and Covenant formed Keycom, LLC (hereinafter "Keycom") - Keystone contributed the Keystone property on behalf of Regal and Covenant contributed its services as a developer. Complaint ¶¶10, 11.

On March 20, 2008, Plaintiffs purchased a 50% ownership interest in Covenant in exchange for: (1) paying Bridgeport one half of the expenses it incurred in developing the Keystone property (Plaintiffs paid $513,149 and $160,000); and (2) making a loan to Keycom for $3,110,000. Complaint ¶¶9, 20, 25. To memorialize their joint venture, the parties signed the First Amended and Restated Operating Agreement of Covenant Partners, LLC (hereinafter "Covenant Operating Agreement"). See Exhibit 1 to Scruggs Aff. Plaintiffs now claim that, Defendants, through a series of misrepresentations, induced them to purchase the 50% membership interest in Covenant. Complaint ¶¶ 23, 24, 26. Based on those allegations, Plaintiffs advance five theories of liability against Defendants: (1) common law fraud; (2) joint liability of Markley; (3) violation of the Oregon Securities Act, ORS Chapter 59; (4) financial **abuse** of a vulnerable person (also kown as **elder** **abuse**); and (5) derivative claim for breach of fiduciary duty.

Hudler moves for summary judgment or partial summary judgment as to each of Plaintiffs' claims against him.

POINTS AND AUTHORITIES

I. SUMMARY JUDGmENT STANDARD:

Summary judgment is appropriate where there is no genuine issue of material fact, entitling the moving party to judgment as a matter of law. ORCP 47; *See borg v. General Motors Corp.,* 284 Or 695, 699 (1978). A genuine issue of material fact exists where "the record before the court taken in light most favorable to the [nonmoving party]" could allow an objectively reasonable juror to return a verdict for that party on each issue raised in the motion. Id. In other words, for a genuine factual issue to exist, there must be sufficient evidence in the record to establish the existence of a triable issue on a question that is material to the legal determination. *Jones v. General Motors Corp.,* 325 Or 404, 413-14 (1997) (citing *Seeborg v. General Motors Corp.,* 284 Or 695 (1978) and equating summary judgment standard to the standard for directed verdict).

Pursuant to ORCP 47 C, "[t]e adverse party has the burden of producing evidence on any issue raised in the motion as to which the adverse party would have the burden of persuasion at trial." Therefore, the burden lies with Plaintiffs. To defeat Defendants' motion, Plaintiffs must produce admissible evidence to show that a genuine issue of material fact exists as to each element of her claim. *See Classic Instruments, Inc. v. VDO-Argo Instruments, Inc.,* 73 Or App 732, 746 (1985).

II.FRAUD:

To prevail on a fraud claim, plaintiff must prove each element of the claim by clear and convincing evidence. *OPERB v. Simat, Helliesen & Eichner,* 191 Or App 408, 423 (2004). Elements of actionable fraud are: (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of the representation's falsity or ignorance of its truth; (5) intent that the representation be acted on by the hearer and in the manmer reasonably contemplated; (6) the hearer's ignorance of the falsity of the representation; (7) the hearer's reliance on its truth; (8) the hearer's right to rely on the representation; and (9) damage. *Musgrave v. Lucas,* 193 Or 401, 410 (1971). The absence of any one element from plaintiffs case is fatal to recovery. *Palm berg v. City of Astoria,* 112 Or 353, 383 (1924) (*quoting Wheelwright v. Vanderbilt,* 69 Or 326, 328 (1914)). Therefore, as to each

of Hudler's representations, Plaintiffs must establish that they had the right to rely on the representation, that the representation was material and that they did not know of its falsity.

Plaintiffs rely on eight distinct alleged representations to make out their fraud claim against Defendants: [1]

1. Defendants represented to Cruze that they were successful real estate developers and they owned a successful and legitimate real estate development business. Complaint ¶13.
2. In May of 2007, Defendants took Pat Jay, Plaintiffs' real estate broker, to Reno, Nevada to view eight real estate projects that Defendants represented they owned or were acquiring. Complaint ¶14.

3. In the Summer of 2007, Hudler took Plaintiffs to several projects in Lake Oswego, Oregon and represented that the projects had been developed by Defendants. Complaint ¶15.

4. On June 5, 2007, Hudler faxed his financial statement to Cruze, in which he represented that he (and his wife) had a net worth in excess of $30 million. Complaint ¶16.

5. In March of 2008, Hudler showed Cruze a 35-acre parcel of property located in Reno, Nevada and represented to Cruze that Defendants owned the property and that it was being developed for residential purposes. Complaint ¶19.

6. Defendants represented that Bridgeport had paid to or on behalf of Covenant $1,026,298 for (i) costs of obtaining development right for the Keystone Property; and (ii) payments for loans secured by Keystone property. Complaint ¶21.

7. Hudler represented to Plaintiffs that their loan to Keycom would be secured by a first priority trust deed on the westerly 40 acres of the Keystone Property and by a second priority trust deed on the easterly 60 acres. Complaint ¶22.

8. In April of 2008, Hudler requested that Cruze make a capital contribution to Covenant in the amount of $160,000, which Hudler represented consisted of (i) $64,571 for one half of Bridgeport's contributions to Covenant from January 1, 2008 through March 20, 2008, and (ii) $74,336 for one-half of the entitlement expenses due to Summit Engineering and RNL Enterprises and Design and the balance for future entitlement costs. Complaint ¶25.

Factual disputes may prevent summary judgment in Hudler's favor on Plaintiffs' fraud claim in its entirety. However, partial summary judgment is appropriate because Plaintiffs' claim fails as a matter of law with respect to Hudler's alleged representations 1, 4, 6, 7, and 8. Simply put, Plaintiffs cannot establish the necessary elements of fraud with respect to those representations. Specifically, they cannot establish that: (a) representation 1 was false; (b) they had the right to rely on representations 4, 6, 7, and 8; (c) representation 4 was material in their decision to invest in Covenant; or that (d) they relied on the truth of representation 6. Therefore, Hudler is entitled to summary judgment with respect to representations 1, 4, 6, 7, and 8.

a. Plaintiffs cannot establish that Hudler's alleged representations that he was a real estate developer and owned a legitimate real estate development business were false.

Plaintiffs claim that Defendants represented to them that they were successful real estate developers and that they owned a successful and legitimate real estate development business. Complaint ¶13. Plaintiffs further claim, without alleging any specifics, that those representations were false because "defendants were not operating a legitimate real estate development business, [and] were not experienced real estate developers." Complaint ¶ 27. Even if such representations were, in fact, made to Plaintiffs, they cannot establish that the representations were false as to Hudler.

Hudler has been in the real estate business for more than 32 years. *See* Hudler Dec. ¶ 2. In 1977, he became licensed as a real estate salesman in California and began working for Villa Associates real estate agency, where he quickly became the top

producer. *Id.* at ¶3 In 1985, he joined Centurion Investments in Newport Beach, California, a real estate firm that specialized in the sale of development and investment grade real estate. *Id.* Two years later, Hudler, along with a partner, formed Chaparral Investments in Newport Beach, California. Id. Over the next eight years, Chaparral Investments represented and partnered with other entities to develop and sell investment properties, including residential, commercial and multi-family projects. *Id.* In 1995, Hudler left Chaparral Investments and formed The Commonwealth Companies, Inc. to conduct his real estate development business. *Id.* at ¶ 4. Since then, he has developed multiple commercial and residential projects, including:

* Spruce Village Apartments in Riverside, CA (1999-2000): was a two-phase residential project. Hudler developed the second phase of the project, consisting of 104 apartment units, and oversaw all aspects of acquiring and constructing the second phase of this project.

● LA Fitness Sports Club in Murrieta, CA (2000-2001): was a two-phase commercial project. Hudler developed both phases of the project - the LA Fitness Sports Club (approximately 35,000 square feet) and the subsequent expansion of the club (approximately 10,000 square feet). Hudler oversaw all aspects of acquiring and constructing this project.

● LA Fitness Sports Club and Shopping Center in Mill Creek, WA (2005-2006): was a two-phase commercial project. During the first phase, Hudler developed the property for another LA Fitness Sports Club (approximately 45,000 square feet). During the second phase, Hudler developed the remaining property with a multi-tenant strip retail building (approximately 13,000 square feet). Once again, Hudler oversaw all aspects of acquiring and constructing this project.

● Bella Rio in Reno, NV (2004-2006): was a multi-phase residential project consisting of 72 homes (ranging from 2,068 to 3,021 square feet). Hudler developed portions of this project.

Id. ¶¶4(a)-(d). Based on these projects alone, Hudler had substantial experience developing residential and commercial real estate projects. By the time he met Plaintiffs in May of 2007, Hudler had made a career as a real estate developer and was working on developing several other projects. *Id.* at ¶ 6. Therefore, Plaintiffs cannot establish that Hudler's alleged representation that he was a real estate developer was false.

Likewise, Plaintiffs cannot establish that Hudler's alleged representation that he owned a legitimate real estate business was false. Oregon courts have never discussed the definition of “legitimate” in the context of operating a business. Adhering to the plain meaning rule, “legitimate” is defined as “that which is lawful, legal, recognized by law, or according to law” or “real, valid, or genuine.” *Black's Law Dictionary* 811 (5th ed 1979). As noted above, in 1995, Hudler formed The Commonwealth Companies, Inc. to conduct his real estate development business. *See* Hudler Dec. at ¶ 4. The Commonwealth Companies, Inc. was established in accordance with the Delaware State law and was recognized by the State of Delaware as a genuine business entity. *See* Exhibit 2 to Scruggs Aff. In 2005 and 2006, Hudler, along with Markley, formed Bridgeport Group, LLC and Bridgeport Communities, LLC to conduct their real estate development business in Oregon. See Hudler Dec, at ¶ 5. Both entities were established in accordance with the Oregon State law and are recognized by the State of Oregon as genuine business entities. See Exhibit 3 to Scruggs Aff. Therefore, Plaintiffs cannot establish that Hudler's alleged representation that he owned a legitimate real estate development business was false.

As for Hudler's alleged representations that he was a “successful” real estate developer and owned a “successful” real estate business, those representations, even if actually made by Hudler, cannot be construed as anything other than expressions of opinion or belief, which are not actionable as fraud under Oregon law. *Horner v. Wagy,* 173 Or 441, 458 (1944). The rule is well settled that mere general commendations of the object of the sale, sometimes called “trade talk,” “dealers' talk,” “sellers' statements,” or “puffing,” do not attain the status of fraudulent representations where the parties deal at arm's length. *Miller v. Protrka,* 193 Or 585, 596 (1951). “Such statements usually are regarded as mere expressions of opinion upon which a purchaser cannot safely rely.” *Id.* This is especially true of statements made by the vendor commendatory of the thing which he is trying to sell, such as that it is a good investment (*Howard v. Merrick,* 145 Or 573, 579 (1933)) or that it is of great value (Grant v. Cartozian Bros., 120 Or 607, 611 (1927)). When the form of the statement and the circumstances under which it was made are

such that it cannot be fairly construed as anything but a expression of an opinion or belief, it is proper for the court to hold that the statement is not actionable as fraud. *Miller, supra,* 193 Or at 597 (internal citations omitted).

Here, Hudler made the alleged representations when he first approached Plaintiffs about partnering with them to develop properties in Lake Oswego, Oregon. Complaint ¶12. According to Pat Jay, Plaintiffs' real estate broker, during the parties' initial meetings. Hudler "was trying to convince Mr. and Mrs. Cruze to do a venture with him." *See* Exhibit 4 to Scruggs Aff. At that stage, Hudler was obviously self-promoting and his general statements that he was "successful" and owned a "successful" real estate business cannot be fairly construed as anything more than puffery or expressions of opinion. As such, those statements are not actionable as fraud.

Since Plaintiffs cannot establish that Hudler's alleged representations that he was a real estate developer who owned a legitimate real estate business were false and since Hudler's generalized statements about his success are not actionable, Hudler is entitled to summary judgment as to those representations,

b. Plaintiffs had no right to rely on Hudler's representations 4, 6, 7 and 8.

The existence of plaintiffs right to rely is a legal conclusion and does not need to be pleaded as an ultimate fact in the complaint. *U.S. National Bank v. Fought,* 291 Or 201, 222 (1981). Therefore, whether Plaintiffs had the right to rely on Hudler's representations is a question for the court. *See U.S. National Bank, supra,* 291 Or at 222; *Womer v. Melody Woods Homes Corp.,* 165 Or App 554, 560 (2000).

i. Buyer has a duty to investigate seller's representations.

"[T]he 'right to rely' element of a fraud claim under Oregon law requires proof of the reasonableness of the reliance." *OPERB, supra,* 191 Or at 428. Whether a buyer can reasonably rely on a seller's representation depends on the extent to which the buyer is required to investigate the accuracy of the representation. *See Johnson, supra,* 204 Or at 150. The buyer is required to investigate when he "ha[s] or can obtain equal means of Information and [is] equally qualified to judge certain factors" surrounding the representation. *Miller v. Protrka,* 193 Or 585, 597 (1951). If the buyer fails to so investigate, his reliance on the seller's representation is not reasonable and he cannot later recover against the seller on the ground of being misled. *Baker v. Casey,* 166 Or 433, 437 (1941), *cited for the same proposition in Hall v. Fitzhugh,* 80 Or App 423, 426 (1986).

In *Baker,* following a real estate sale, buyer sued seller for fraud based on the seller's representations regarding the condition of the property. *Id.* at 434. In affirming judgment for the sellers, the Supreme Court of Oregon noted:

> It is, of course, well settled that a purchaser must use reasonable care for his own protection, and should not rely blindly upon statements made by a seller, and that, between parties dealing at arm's length, where no fiduciary relationship exists and no device or artifice is used to prevent an investigation, it is the general rule that a purchaser must make use of his means of knowledge, and, failing to do so, he cannot recover on the ground that he was misled by the seller.

Id. at 437.

A decade later, citing its reasoning in Baker, the court declined to hold sellers of a motel liable for fraud where the buyers had the opportunity, but failed to verify the sellers' buyers regarding the motel's annual gross income, annual expenses, and annual net return that were not entirely accurate. *Id.* at 589-91. The buyers could have verified the sellers' representations by examining the sellers' accounting records but proceeded with the purchase without doing so. *Id.* at 601. Those facts, the court held, "precluded a successful charge of fraud." *Id.* The court held so even though the buyers had no previous motel experience, but had owned an apartment building. *Id.* at 588. The buyers' sizeable $25,000 down payment represented to the court they

"were endowed with some business acumen of substance and had enjoyed some profit from their enterprise, a part of which, no doubt, came from their apartment venture." *Id.* In closing, the court reflected on the case and its role:

It may be true that the Protrkas made an improvident bargain but, as was said in *Crouch v. Butler, 119 Or. 344, 349, 248 P. 849,850:* '***The courts cannot act as guardian for a man sui juris, who is competent to contract, and who has every opportunity to satisfy himself of the extent and value of the property which he is purchasing', and to which we add, the opportunity in this instance to verify the statements concerning income from the sellers' elementary and quickly informing books of account.

Id. at 602-3. Because the buyers could have obtained information to verify the sellers' representation and were qualified to judge that information, they could not reasonably rely on the sellers' representations without doing an investigation. *Id.*

Some thirty years later, the court reaffirmed the principles articulated in *Baker* and *Miller. Coy v. Starling,* 53 Or App 76, 81-82 (1981), cited with approval in *Vasquez-Lopez v. Beneficial Oregon Inc.,* 210 Or App 553, 580 (2007). In Coy, buyers of a motel sued the sellers for fraud in overstating the motel's annual gross income by $15,000 and understating the motel's annual expenses by $4,000 in the property listing agreement. *Id.* at 78-79. Prior to making the purchase, the buyers inspected the motel but not the motel books or records, including the records which they themselves requested. *Id.* at 78. Because of that and the fact that the buyers were not naive concerning business matters and knew of the books' existence, the trial court granted the sellers' motion for a directed verdict on the buyers' fraud claim. *Id.* at 79-80. Relying on Baker and Miller, the Court of Appeals agreed with the trial court that the 'plaintiffs were not justified in relying upon [defendants' representations] without further inquiry.' *Id.* at 79, 82. The court held that it was unreasonable for the buyers to rely on the sellers' representations of income and expenses because the buyers "had sufficient experience in business to know that the motel's financial records should be examined." *Id.* at 81.

Here, Plaintiffs were not just experienced real estate investors, but as the founders and operators of a multi-million dollar company, were remarkably savvy in business transactions.

ii. Plaintiffs were sophisticated buyers.

To describe Mr. and Mrs. Cruze as financially sophisticated would understate their achievements. In 1973, Tyrone Cruze, Sr. (hereinafter "Cruze") along with friends, started Custom Chrome, Inc., an independent supplier of custom motorcycle parts and accessories. *See* Exhibit 5 to Scruggs Aff. He quickly bought out all his partners and by 1976, became the sole shareholder. *Id.; Custom Chrome, Inc. v. Commissioner,* 76 TCM (CCH) 386 (1998) (memorandum decision), *aff'd in part, rev'd in part,* 217 F3d 1117 (9th Cir 2000), attached as Exhibit 6 to Scruggs Aff. From 1975 until 1991, Cruze served as the company's president and chief executive officer, overseeing the company's progress and success. See Exhibit 5 to Scruggs. Aff. Jacqueline Cruze served as the vice president and maintained an active role in the company. *Id.* As the company's leader, Cruze was not only involved in all major company decisions, but "maintained final decision-making authority over all aspects of [the] business operations." See Exhibit 5 to Scruggs Aff.; Custom Chrome, Inc., supra, 76 TCM (CCH) 386. In Custom Chrome, Inc. the court aptly summarized Cruze's role in the coman:

> Cruze established significant business contracts with bankers, suppliers, and vendors who were important to the business operations and success of [the company]. Cruze was well known and respected in the motorcycle parts business, and his ideas, efforts, and management skills contributed significantly to the growth and success of petitioner.

Custom Chrome, Inc., supra, 76 TCM (CCH) 386. In fact, under Plaintiffs' leadership, Custom Chrome, Inc. thrived, becoming, the largest independent worldwide supplier of Harley-Davidson motorcycle parts and accessories. *See id.*

In the late 1980s, after significant negotiations, the Jordan company purchased all of Cruze's stock through a leveraged buyout for $16.75 million, along with an extra $5 million for a covenant not to compete and an additional $2.6 million to enable him

to pay federal taxes for prior years. *See* Custom Chrome, Inc. v. CIR, 217 F3d 1117, 1119 (9th Cir 2000), attached as Exhibit 7 to Scruggs Aff. After the purchase, the acquisition company used for the deal was merged into Custom Chrome, Inc., which became a wholly-owned subsidiary of the holding company. *Id.* In 1991, the company went public and Cruze resigned his post as the chief executive officer, but served on the Board of Directors until 1996. *See* Exhibit 8 to Scruggs Aff. While at Custom Chrome, Inc., Cruze expanded his business acumen, becoming savvy in complicated financial transactions, such as highly-leveraged transactions. *See* Exhibit 9 to Scruggs Aff. (Cruze explaining the basics of a leveraged buyout transaction to the court).

Since leaving the company, Plaintiffs have been investing in real estate and using their money to make private loans secured by real estate. See Exhibit 10 to Scruggs Aff. As of September of 2007, Plaintiffs had made at least 40 or 50 such loans, amounting to "between $11 and $13 million." *Id.* Plaintiffs have also partnered with various parties to develop real estate, including a large residential home project in Lincoln City, Oregon, a project in Blanchard, Idaho, and multiple projects in Lake Oswego, Oregon. *See* Exhibit 11 to Scruggs Aff. Obviously, Plaintiffs were no strangers to the real estate business. Accordingly, they represented and warranted in the Covenant Operating Agreement that they "[had] knowledge and experience in financial and business matters and [were] capable of evaluating the risks and merits of an investment in [Covenant]." *See* Exhibit 12 to Scruggs Aff.

Plaintiffs are also well-acquainted with the concept of due diligence. In 2005, Tom Scott, a local developer, approached Cruze about making a short-term loan on a project in Lake Oswego, Oregon. *See* Exhibit 13 to Scruggs Aff. Before investing in the project, Cruze traveled to Lake Oswego to do his due diligence. *See* Exhibit 14 to Scruggs Aff. Besides consulting with his long-time financial manager and at least two attorneys, Cruze did 'some of [his] own due diligence with respect to the properties," which he described in the following way:

Cruze: I met with Gail Oldham, which is a builder in the Portland area here, to get his opinion on what the worst case value of this property, because - well, let's - let's leave it at that, because you don't want me to go on and on.

McDonald: No. I do want you to finish that question -

Cruze:*I - I - a private investment of private money does their due diligence a little bit different than conventional financiers. Conventional financiers look at a deal and try to make sure that this deal is going to be a positive deal and not fail.

Private placement money looks at deals and says, "If this thing fails, if the buyer fails, worst case, what do I have of value to recover my investment?" And I was trying to get a feel of what Lake Oswego values were at worst case, in case this failed, that I could come out whole.

See id. Cruze agreed to make the loan only after becoming satisfied with the value of the property. *See* Exhibit 15 to Scruggs Aff.

Cruze also did due diligence on Hudler upon meeting him in early 2007 but before partnering with him on their first project. *Cruze* sent his real estate broker "to look at [Hudler's] projects to see how credible he is" and to "review the success that Martin [Hudler] had in developing projects." *See* Exhibit 16 to Scruggs Aff. After inspecting the properties, Pat Jay reported back to Cruze and provided him various supporting documentation, which Cruze then personally reviewed. *See id.* Cruze decided to proceed with their first joint venture only after he became "comfortable" with Hudler. See Exhibit 17 to Scruggs Aff. It is apparent, therefore, that Cruze not only understood the process of due diligence, but appreciated its importance.

iii. Plaintiffs conducted no investigation into Hudler's representations regarding Bridgeport's expenses [representations 6 and 8].

Plaintiffs claim that before they agreed to join Covenant, Hudler represented to them that Bridgeport had spent $1,026,298 on behalf of Covenant for obtaining development rights for the Keystone property [representation 6]. Complaint ¶ 21. Plaintiffs further claim that in April of 2008, Hudler represented to them that Bridgeport had incurred additional expenses and requested that Plaintiffs make a capital contribution of $160,000 to pay: (i) $64,571 for one half of Bridgeport's contributions to Covenant

from January 1, 2008 through March 20, 2008; and (ii) $74,336 for one-half of the entitlement expenses due to Summit Engineering and RNL Enterprises and Design and the balance for future entitlement costs. Complaint ¶ 25 [representation 8]. Plaintiffs now claim that, in fact, Bridgeport had contributed less than $500,000 to Covenant for the development expenses. Complaint ¶ 28. Plaintiffs also claim that Bridgeport's contributions to Covenant from January 1, 2008 through March 20, 2008 were substantially less than $64,571 and one-half of the amounts due to Summit and RNL were substantially less than $74,336. Complaint ¶32. Even if Hudler made the alleged representations, Plaintiffs had no right rely upon them without further inquiry.

Plaintiffs conducted absolutely no investigation into Hudler's representations regarding Bridgeport's expenses before joining Covenant. See Exhibit 18 to Scruggs Aff. In spite of their knowledge and experience, they signed and entered into the agreement relying solely on Hudler's alleged representations. And they did that without ever obtaining the information necessary to verify the expenses, despite having ample opportunity to do so. Id. Plaintiffs represented and warranted in the Covenant Operating Agreement that they:

[Have] received information from and *[have] had the opportunity to ask questions of, and receive answers from, representatives or agents of the Company in order to verify the information which has been provided to [them] about the Company and about the terms and conditions of [their] investment in the Company. [They] [have] obtained all the information desired by [them] in connection with this offering and [have] no unanswered questions at the time of becoming a Member.*

See Exhibit 19 to Scruggs Aff. (underline emphasis added). Under Oregon law, Plaintiffs had an absolute duty to use reasonable care for their own protection by investigating Hudler's representations. Their failure to investigate, for whatever reason, negates their claim and results in loss of the right to rely. *Cov. supra* 53 Or A at 81-82.

Plaintiffs could have easily done what they are doing now — verified Hudler's representations regarding Bridgeport's project-related expenses by examining Covenant's or Bridgeport's books or by hiring a professional to perform an audit of the expenses. Plaintiffs were shrewd investors, who, without a doubt, had sufficient business acumen to know that, at the very least, accounting records should be examined. They simply chose not to do so, and entered into the contract even though the circumstances surrounding the investment were such that even the most naive investor would investigate.

In his deposition, Cruze testified that Hudler initially told him that Plaintiffs would have to reimburse Bridgeport $300,000 or $400,000 for project expenses in order to buy into Covenant. See Exhibit 20 to Scruggs Aff. Much to Cruze's surprise, that amount grew to $513,000 because Hudler did “an exact accounting” of how much Bridgeport had really spent. *Id.* Cruze became concerned that his required contribution grew by some $150,000 and requested “proof” of the expenses, including a copy of the detailed audit Hudler had performed. *Id.* According to Cruze, Hudler “was supposed to provide [proof of Bridgeport's expenses] immediately” upon request. *Id.* Cruze never received the proof he asked for, but proceeded with the deal anyway. *Id.* Notably, Plaintiffs did not condition the deal on the receipt of any proof and, in fact, represented that they obtained all the information they desired to verify the representations made in connection with the deal. *See* Exhibit 19 to Scruggs Aff. Here, like the buyers in Miller, Plaintiffs were financially sophisticated, competent to contract and had the opportunity and the means to verify the accuracy of Hudler's representation that Bridgeport had spent $1,026,298 on the project. Because they failed to so, they lost their right to rely on that representation.

Cruze continued to demand proof of the expenses and, specifically, asked for “invoices and cancelled checks” after joining Covenant on March 20, 2008. See Exhibit 21 to Scruggs Aff. He never received the proof he was looking for and was very surprised when in April of 2008, Hudler requested that Plaintiffs make another contribution of $160,000 to cover additional project expenses, including the money due to Summit Engineering and RNL Enterprises and Design for their work on the project. *Id; see* Exhibit 22 to Scruggs Aff; Complaint ¶25. Having not received proof of Bridgeport's $1,026,298 contribution, one would expect Cruze to withhold payment until he was satisfied that Bridgeport's new expenses were, in fact, accurate and justifiable. Instead, Cruze made no effort to verify the new expenses and responded by paying $160,000 on April 18, 2008. *Id.*

Oregon law is clear: Plaintiffs had a duty to investigate Hudler's representations regarding the accuracy of Bridgeport's expenses. They clearly had a duty of due diligence and they knew it. That they did not assert it before entering into the agreement with Defendants cannot now form the basis of their claim. They had the business acumen to know that such an investigation should be done and the wherewithal to analyze the results. They did not and in not doing so, they are presumed to have all the knowledge they could have obtained through an investigation. *See Housley v. Linnton Plywood Ass'n,* 210 Or 520, 529 (1957) (it is well established that notice of acts or circumstances which could put a person of ordinary intelligence upon inquiry amounts to knowledge of all facts that a reasonably diligent inquiry would disclose). Therefore, Hudler is entitled to summary judgment with respect to representations 6 and 8.

iv. Hudler's representation that he and his wife were worth more than $30 million [representation 41 was not a material factor in Plaintiffs' decision to invest in Covenant. In addition, Plaintiffs had no right to rely on Hudler's financial statement.

Plaintiffs claim that Hudler represented to them that he and his wife were worth more than $30 million. Complaint 116. That representation, Plaintiffs claim, was "a material factor in [their] decision to become a member of [Covenant]." Complaint ¶33. That representation, Plaintiffs further claim, was false because Hudler's financial statement contained material misstatements and grossly overstated the Hudlers' net worth. Complaint ¶31. Plaintiffs cannot prevail on their fraud claim unless they can prove that each of Hudler's alleged representations was material to their decision to invest in Covenant. *Musgrave v. Lucas,* 193 Or 401, 410 (1971); *Palmberg v. City of Astoria,* 112 Or 353, 383 (1924). In context of a fraud claim, a misrepresentation is material when it would be likely to affect the conduct of a reasonable man with reference to a transaction with another person. *Heverly v. Kirkendall,* 257 Or 232, 237 (1970). Hudler's representation that he and his wife were worth more than $30 million was not a material factor in Plaintiffs' decision to invest in Covenant.

Cruze admitted in his deposition that the amount of Hudler's net worth was not a material factor in his decision to invest. See Exhibit 23 to Scruggs Aff. Cruze testified that there was not a "target number" of net worth he was looking for and said:

If [Hudler] was worth $20 million, that probably would have been satisfied, if he was worth $70 million, I would have been satisfied. No, I didn't have a target number.

Id. In fact, Cruze testified that he "would have been" satisfied even if Hudler was worth $10 million, clean and clear of debt. Id. The amount of Hudler's net worth did not affect Plaintiffs' conduct in this case - they still would have invested in Covenant even if Hudler was worth a third of what he allegedly claimed to be worth. Hudler's representation that he and his wife were worth more than $30 million, therefore, was not a material factor in Plaintiffs' decision to invest in Covenant. For that reason, Plaintiffs cannot maintain an action for fraud with respect to that representation.

Even if Hudler's representation about his net worth was a material factor in Plaintiffs' decision to invest, Plaintiffs still cannot prevail on their fraud claim because they had no right to rely on Hudler's financial statement.

On June 5, 2007, Hudler provided Plaintiffs with a financial statement dated March 31, 2007. *See* Exhibit 24 to Scruggs Aff. The bulk of Hudler's assets was made up of real estate and a schedule of real estate was attached to the financial statement. *Id.* The real estate schedule was based on the "estimated fair market values" of the listed properties, which were "determined by comparing" the subject properties to similar surrounding properties, appraisal or pending sales" as of March 31, 2007. Id. Plaintiffs joined Covenant on March 20, 2008, almost a full year after Hudler's financial statement was prepared. *See* Exhibit 1 to Scruggs Aff. By then, the economy was on the downturn and the real estate values were plummeting. [2] As evidenced by Cruze's own testimony in *Stark v. American Dream Holdings, Inc.,* he had enough business acumen to know that real estate values do not remain constant for a year, especially in a bad economy. *See* Exhibit 25 to Scruggs Aff.

Despite their sophistication, Plaintiffs made no effort to verify the value of the properties listed on Hudler's outdated financial statement. They could have asked Hudler to provide comparable sales analyses and appraisal reports or, at the very least, an

WestlawNext © 2016 Thomson Reuters. No claim to original U.S. Government Works.

updated financial statement before joining Covenant. They never did. Plaintiffs had a duty to investigate Hudler's representation about his net worth before relying on that representation and investing in Covenant. Because Plaintiffs failed to do so, they had no right to rely on Hudler's representation. Therefore, Hudler is entitled to summary judgment with respect to representation 4.

v. Plaintiffs knew that their security interest on the westerly 40 acres of the Keystone property was subject to Regal's right to receive 9.75 acres of that parcel free and clear and had no right to rely on Hudler's alleged representation otherwise [representation 7].

Plaintiffs claim that Hudler represented to them that their loan to Keycom would be secured by a first priority trust deed on the westerly 40 acres of the Keystone property and by a second priority trust deed on the easterly 60 acres. Complaint ¶ 22. Plaintiffs now claim that Hudler's representation was false because Regal was entitled to have 9.75 acres from the westerly parcel free and clear of the Plaintiffs' trust deed. Plaintiffs knew that all along and had no right to rely on Hudler's representation to the contrary. Plaintiffs cannot prevail on their fraud claim unless they can prove that they did not know that each of Hudler's alleged representations was false and they had the right to rely on each of the representations. *Musgrave v. Lucas,* 193 Or 401, 410 (1971); *Palmberg v. City of Astoria,* 112 Or 353, 383 (1924).

In his deposition, Cruze admitted that Hudler told him that Regal was entitled to receive 9.75 acres from the western part of the property free and clear of their trust deed. *See* Exhibit 26 to Scruggs Aff. Plaintiffs knew that before joining Covenant and making the loan to Keycom. On the first page of the Covenant Operating Agreement, it was recited that:

Covenant is a member of Keycom, LLC, a Nevada limited liability company ("Keycom"), which will become the fee owner of that certain real property located in Reno, Nevada consisting of approximately 105 acres (*less 9.75 acres to be deeded to others as outlined in the Keycom operating agreement*) and more particularly described in **Exhibit "A"** attached hereto and by reference incorporated herein (the "Property").

See Exhibit 27 to Scruggs Aff. (underline emphasis added). Plaintiffs signed the operating agreement, and initialed each page, acknowledging that they read it in its entirety. *Id.*

Then on April 16, 2008, Plaintiffs retained a Nevada attorney, Joan Wright, to "act as scrivener of loan documents" for Plaintiffs' loan to Keycom. *See* Exhibit 28 to Scruggs Aff. Shortly thereafter, Ms. Wright prepared a draft of the Deed of Trust and Assignment of Rents (hereinafter the "Deed") and sent the document to Plaintiffs for approval. *See* Exhibit 29 to Scruggs Aff. The Deed identified Keycom, LLC as the Trustor, the Cruze Family Trust, c/o Tyrone Cruze and Jacqueline Cruze, as the Beneficiary and stated:

13. *RELEASE:* At any time during after the date hereof, the Beneficiaries agree to release from the lien and encumbrance of this Deed of Trust and Assignment of Rents, nine and three quarters acres (9.75 acres) within the area shown on Exhibit "B" attached hereto and incorporated herein by this reference as designated solely in Trustor's discretion upon payment of $10 and submission to Beneficiaries of a legal description of the property to be reconveyed. The obligation to convey shall be enforceable even if the obligations secured hereby are in default.

Id. Exhibit "B" - a map of the Keystone property - was attached to the Deed. *Id.* A portion of the property on west side of the parcel was clearly marked with diagonal shading. *Id.* The legend right below the map clearly stated what the shaded area designated:

General Location of the 9.75 Acres to be transferred to Regal Pointe, Inc. / Keystone Community Corporation per the Keycom, LLC operating Agreement and the Promissory Note and Deed of Trust which this map is to become a part thereof.

Plaintiffs read, corrected, and approved the document, as evidenced by their signatures in the READ AND APPROVED box on the front page. *Id.; see* Exhibit 30 to Scruggs Aff. Since Plaintiffs read the document, they knew that Regal was entitled to

receive 9.75 acres from the westerly parcel free and clear of their trust deed before they joined Covenant and made the loan to Keycom. Given that knowledge, they had to know that Hudler's alleged representation regarding the 9.75 acres was false. By the same token, given that knowledge, Plaintiffs were not justified and had no right to rely on any representation to the contrary. Therefore, Hudler is entitled to summary judgment with respect to representation [3].

III. SECURITIES FRAUD:

Plaintiffs' third claim against Defendants is for violation of the Oregon Securities Act, and specifically, violation of ORS 59.115, ORS 59.135, and ORS 59.137. These three statutes form one cause of action.3 In order to prevail on a claim of securities fraud, the allegedly defrauded purchaser must prove that (1) the seller sold or successfully solicited the sale of a "security" to the purchaser; (2) by means of an untrue statement of material fact or by omitting a material fact necessary to make the seller's statements not misleading; and that (3) the purchaser did not know of the untruth or the omission at the time of the sale or solicitation. ORS 59.115(1)(b). Here, Hudler is entitled to summary judgment because, as a matter of law, Plaintiffs cannot establish the first element of their claim - that their interest in Covenant was a "security."

a. Definition of "security" under Oregon law.

The first element in any claim for securities fraud is whether or not the defendant sold or solicited the sale of a "security" to the purchaser. ORS 59.115(1)(b); ORS 59.135. In Oregon, the term security is defined as:

> A note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in a pension plan or profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, variable annuity, certificate of deposit for a security, certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such title or lease, real estate paper sold by a broker-dealer, mortgage banker, mortgage broker or a person described in subsection (1)(b) of this section to persons other than persons enumerated in ORS 59.035 (4), or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificates for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing.

ORS 59.015(19)(a) (underline emphasis added). Notably, ownership interests in limited liability companies are not listed in this definition. Therefore, if Plaintiffs' interest in Covenant is to qualify as a security, it must qualify as an "investment contract" under ORS 59.015.

Oregon law defines an investment contract as "(1) an investment of money (or money's worth), (2) in a common enterprise, (3) with the expectations of a profit, and (4) to be made through the management and control of others." *Pratt v. Kross, 276* Or 483, 497 (1976). When all four elements are present in a particular transaction, Oregon courts will hold that the sale involves an investment contract and, thus, a security. *See, e.g., Computer Concepts, Inc. v. Brandt,* 310 Or 706, 712-13 (1990). Whether a particular business interest constitutes an investment contract (and thus a security) is a question of law for the courts. Robinson v. Glynn, 349 F3d 166, 170 (4th Cir 2003). [4]

By design, not all business interests can satisfy the *Pratt* test. Private, one-to-one transactions (where the buyer is financially sophisticated and the terms of the deal are negotiated) pose a special problem under Oregon's securities statutes. Securities law protections are typically unnecessary in private, one-to-one transactions because, when the parties are savvy at business and stand on equal footing, the risk of fraud is both "quantitatively and qualitatively reduced." Id. at 492 (citing Coffey, The Economic Realities of a "Security": Is *There a More Meaningful Formula?* 18 W Res L Rev 367 (1967)).

‚Having said that, the Oregon Supreme Court admits that the first three elements of the *Pratt* test cast a wide net, in order to ensure that the disputed transaction includes "all the essential economic characteristics of a security." *Id.* at 490. By contrast, the fourth element of Pratt serves a different function: to "cut-off" the applicability of securities law to certain private, one-to-one transactions. *Id.* at 493; 497. That is, a purchaser's interest in a business venture qualifies as an investment contract only if the purchaser, by necessity, depends on someone else to manage and control his investment. *Id.* at 495-96. In other words, the fourth element is satisfied only where the purchaser is relegated to the role of a "purely passive investor." *Id.* at 497. By contrast, where the purchaser has the right to meaningfully control (i.e., participate in the management of) his investment, his interest cannot satisfy Pratt's fourth element, *Id.* at 495, 497. In such instances, the purchaser has bargained for the power to oversee and, if needed, to control what happens to his investment. *See id.* at 493-94, 497. Oregon law considers this type of a purchaser to be an active investor, as opposed to passive, and, for that reason, does not afford him the protections of ORS Chapter 59. *See id.* at 497.

b. Plaintiffs cannot satisfy the fourth element of the Pratt test because they had control over their investment; therefore, their interest in Covenant Partners, LLC does not qualify as a "security."

The analysis of investor control is based on the examination of the operating agreement and the level of control retained by the purchaser therein. *Great Lakes Chem. Corp. v. Monsanto Co.,* 96 F Supp 2d 376, 392 (D Del 2000). If the operating agreement leaves significant amount of control in the hands of the purchaser, then the purchaser cannot credibly argue that his expectation of profit was to be derived from the management effort of others. *Keith v. Black Diamond Advisors, Inc.,* 48 F Supp 2d 326, 334 (S D NY 1999). Retention of meaningful authority is evidence that the purchaser "did not intend to be a passive investor" and, thus, his interest cannot be deemed a security. *Id.*

A purchaser need not retain day-to-day managerial control in order to be deemed an active investor. *See Robinson v. Glynn,* 349 F3d 166, 170-72 (4 th Cir 2003); *Great Lakes Chem. Corp., 96 F Supp 2d at 392; Keith,* 48 F Supp 2d at 332-34. Rather, a purchaser needs only to retain enough meaningful control to ensure that other members and managers cannot harm or dilute his investment. *Robinson,* 349 F3d at 171. The operating agreement should also provide the purchaser with "access to important information" such that he can wield his power in an educated manner. *Id.* When this level of control is reserved to the purchaser, the business interest fails the fourth element of Pratt's investment contract test and, thus, fails to qualify as a security. *Id.* at 172; *see also Pratt,* 276 Or at 496-97 (focus of inquiry is quality of the powers retained by the investor).

For example, in *Robinson,* a disgruntled investor of a telecommunications firm, GeoPhone Company, LLC (the "LLC"), sued the defendant for securities fraud. *Robinson,* 349 F3d at 169. The defendant was the original owner and manager of the LLC. Based on allegedly fraudulent information, the investor agreed to contribute $25 million to the defendant's LLC. Id. at 168. In exchange, the investor received a 25% ownership interest in the LLC; the defendant retained the other 75% interest. *Id.* at 169. According to the parties' restated operating agreement, the LLC was managed by seven managers. *Id.* The defendant had the right to appoint five of the seven managers (including himself) and, thus, possessed day-to-day managerial control over the LLC. *Id.* By contrast, the investor had the right to name two of the managers. *Id.* The investor was also appointed treasurer and was named to the LLC's executive committee, which granted him the right to oversee his investment but not the day-to-day managerial authority. *Id.* at 169, 171. In addition, the LLC's operating agreement granted the investor veto power over certain managerial decisions. The LLC could not incur indebtedness outside the normal course of business without the investor's consent and defendant could not dilute the investor's interest without getting his consent. *Id.* at 171. Moreover, this level of oversight and veto power was the product of careful negotiations between the investor and the defendant. *Id.*

The parties' business relationship deteriorated four months after the investor signed the restated operating agreement. *Id.* at 169. The investor, believing that he had been fraudulently induced to invest in the LLC, brought a federal securities fraud claim against the defendant. *Id.* at 169. Defendant moved for summary judgment on the grounds that the investor's 25% ownership interest did not qualify as an "investment contract" and thus was not a "security" under federal law. *Id.* In particular, the defendant argued that the fourth element of investment contract (whether the investor reasonably expected profits to be derived form the effort of others) was missing. The trial court agreed and dismissed the investor's claim. *Id.*

On appeal, the Fourth Circuit affirmed the dismissal. *Id.* at 172. It held that the investor retained too much control over his investment and, thus, failed to satisfy the fourth clement of the test. The investor argued that the quality of the powers he retained left him unable to exercise "decisive control over major decisions." *Id.* at 171. That was not the relevant inquiry, however. The investor did not bargain for "sole managerial authority." *Id.* Rather, he bargained for "access to important information" about the LLC and he bargained for the power to oversee his investment and to protect his interest from harm. *Id.* With this level of control reserved to the investor, "nothing of consequence that would affect his position adversely could be done without his prior express approval." *Id.* According to the court, that level of control as "antithetical to the notion of member passivity." *Id.* (citing *Keith,* 48 F Supp at 333). Because the investor had the right to take an active role in his investment, the court held that his 25% interest in the LLC could not be classified as a security. *Id.* at 172. Other courts have reached the same conclusion on similar facts. *See* *Keith,* 48 F Supp 2d at 332-34 (treated by other jurisdictions as the seminal case in the LLC context); *Great Lakes Chem. Corp.,* 96 F Supp 2d at 386-87, 390-392 (collecting cases from the late 1990s).

Here, Plaintiffs, much like the investor in *Robinson,* retained too much control over their investment in Covenant for their interest to qualify as an investment contract. In fact, the level of oversight and veto power retained by the Plaintiffs vastly exceeds the powers retained by the investor in *Robinson.*

Covenant is structured in a system of checks and balances. Covenant is a manager-operated LLC. Its manager, Bridgeport, is responsible for the general, day-to-day operations of the company. See Exhibit 31 to Scruggs Aff. Members do not possess general day-to-day managerial authority. *See* Exhibit 32 to Scruggs Aff. Rather, member authority takes the form of voting rights, which may be wielded to place checks and balances on the day-to-day powers of the manager. *See* Exhibit 33 to Scruggs Aff. Specifically, the Operating Agreement divides member authority into two categories: (1) an implied right of veto over certain managerial decisions [5] and (2) an express right of veto over other managerial decisions. [6] Managerial decisions over which Plaintiffs have an implied right of veto include:

* *Causing Loan Defaults* - Bridgeport Communities cannot make any managerial decision that would cause Covenant to default on any loan secured by the Keystone Property without Plaintiffs' consent. *See* Exhibit 34 to Scruggs Aff. (Section 5.3(a)).
● *Appointing and Removing Manager* - No manager of Covenant could be appointed and no manager of Covenant could be removed without Plaintiffs' consent. *See id.* (Sections 5.3(b)-(c)).

● *Setting Member and Manager Compensation* - Bridgeport Communities was entitled to receive compensation for the services it rendered to Covenant as manager. Said compensation would derive from the development fee Keycom LLC paid to Covenant. However, the Operating Agreement does not contain a formula for determining Bridgeport Communities' share of this fee. Rather, the parties agreed that Bridgeport Communities' compensation would be subject to Plaintiffs' consent. *See id.* (Section 5.8).

● *Transferring Voting Rights to Outside Parties* - Bridgeport Communities possessed a limited right to sell its membership interest to outside parties. However, the sale could not include Bridgeport Communities' voting rights unless Plaintiffs approved the transaction. *See id.* (Section 7.5).

Next, managerial decisions over which Plaintiffs' hold an express right of veto include the following:
● *Admitting New Members (Anti-Dilution)* - New members cannot be admitted to Covenant without Plaintiffs' prior, written consent. See Exhibit 35 to Scruggs Aff. (Sections 1.8, 5.4(a)).

● Transactions with "Affiliates" of the Manager (Anti-Self-Dealing) - Covenant cannot enter into any contract with any person or any entity related to or owned by Bridgeport Communities, Hudler, or Markley. Any deviation from this rule requires Tyrone Cruze's express approval. *See id.* (Section 5.20).

● Non-Cash Distributions - All distributions to members must be made in cash, not partnership property. Any deviation from this rule requires Plaintiffs' approval. See id. (Section 5.4(1)).

● *Changing Nature of Business* - Bridgeport Communities cannot change Covenant's business purpose (development of the Keystone Property) without Plaintiffs' express consent. *See id.* (Section 5.4(d)).

● Merger - Bridgeport Communities cannot merge Covenant with another entity or engage in a consolidation or reorganization of Covenant unless Plaintiffs first approve the activity. See id. (Section 5.4(c)).

● *Amending LLC Documents* - Any member can propose amendments to the Operating Agreement and articles of incorporation. However, no amendment can be made without Plaintiffs' approval. See id. (Sections 5.4(b), (e), 10.2).

● *Dissolution* - Bridgeport Communities cannot dissolve Covenant unless Plaintiffs voted to allow the dissolution to go forward. *See id.* (Section 9.1).

Finally, the Operating Agreement provides Plaintiffs with access to important company information, enabling them to wield their voting rights in an educated manner. For example, Bridgeport is required to provide Plaintiffs with: (1) quarterly management reports; (2) yearly financial statements; (3) yearly tax returns; (4) check registers for every bank account opened in Covenant's name; (5) all notices of loan default; (6) all notices of violation of statutory and regulatory law; and (7) all notices of legal proceedings filed against Covenant or filed against the Keystone Property. See Exhibit 36 to Scruggs Aff. (Sections 5.10, 5.19(a)-(c), 6.3-6.5). Moreover, Plaintiffs possessed the right, without notice, to go to Bridgeport Communities' office and inspect/copy any of the Covenant's books and records. See Exhibit 37 to Scruggs Aff. (Section 6.1).

In all of these ways, Plaintiffs had the power and the knowledge necessary to oversee and protect their investment. Plaintiffs did not want day-to-day managerial authority. See Exhibit 38 to Scruggs Aff. Instead, they bargained for the right to be educated about the progress of their investment and bargained for the right to step in, as needed, to correct any issue threatening to derail their expectations of profit. See Hudler Dec. ¶¶ 8, 9. *Like in Robinson,* nothing of significance could adversely impact Plaintiffs' interests without their prior express approval. *See* Hudler Dec. ¶ ¶ 8,9. With this quality and quantity of oversight authority, Plaintiffs were clearly active investors. Oregon and federal law supports that position. Because Plaintiffs retained too much power over their investment in Covenant, they cannot satisfy the fourth element of *Pratt.* Accordingly, their 50% interest in Covenant fails to qualify as a security as a matter of law.

IV. ELDER ABUSE:

Oregon law provides that "[a] vulnerable person who suffers injury, damage or death by reason of physical or financial **abuse** may bring an action against any person who has caused the physical or financial **abuse** or who has permitted another person to engage in physical or financial **abuse**." ORS 124.100(2). To prevail on a claim for financial **abuse**, plaintiff must prove four elements by the preponderance of the evidence: "(1) a taking or appropriation (2) of money or property (3) that belongs to an **elderly** or incapacitated person, and (4) the taking must be wrongful." *Church v. Woods,* 190 Or App 112, 117 (2003).

Hudler is entitled to summary on Plaintiffs' **elder abuse** claim because Plaintiffs cannot establish all the necessary elements of their claim. Specifically, Plaintiffs cannot establish that (1) Hudler took or appropriated Plaintiffs' money or property; or that (2) Hudler's involvement with Plaintiffs' investment in Covenant was "wrongful."

a. Hudler Did Not "Take or Appropriate" Plaintiffs' Money or Property.

WestlawNext © 2016 Thomson Reuters. No claim to original U.S. Government Works.

In *Church,* the court considered what constitutes a "taking" in the context of ORS 124.100. Since ORS 124.100 does not define a "taking," the court adopted the dictionary definition of "take" as "to transfer into one's own keeping [or to] enter into or arrange for possession, ownership, or use of." *Id.* at 117. Church was an 83-year-old bachelor afflicted by Alzheimer's. The defendant transferred interest in plaintiffs property to herself, which included interest in plaintiffs vehicles, plaintiffs checking account, and plaintiffs real property. *Id.* at 115. The court held that because the transfers diminished the vulnerable person's interest in his property, defendant "took" the property within the meaning of the **elder** **abuse** statute. *Id.* at 118.

Here, Plaintiffs do not allege that Hudler took or otherwise arranged for possession, ownership, or use of their money or property. In fact, Plaintiffs make no allegation that Hudler was ever a party to any of the transactions they now claim constituted financial **abuse**. The absence of such allegations is very telling - Plaintiffs appear to concede that Hudler committed no outright "taking or appropriation." Instead, Plaintiffs allege that Defendants "induced" them to invest in Covenant by making certain representations and such an inducement constituted a "taking or appropriation". Complaint ¶ 51. But the evidence is overwhelming that was no inducement.

The Covenant Operating Agreement makes clear that Plaintiffs made a sound decision to invest in Covenant and were not victims of anyone's taking or appropriation. See Exhibit 19 to Scruggs Aff. In Section 10.15.2 of the Operating Agreement Plaintiffs made the following "investment representations:"

1. They have "knowledge and experience in financial and business matters and [are] capable of evaluating the risks and merits of an investment in" Covenant;

2. They "received information from and [have] had the opportunity to ask questions of, and receive answers from, representatives and agents of [Covenant] in order to verify the information which has been provided to [them] about [Covenant] and about the terms and conditions of [Plaintiffs'] investment in [Covenant]";

3. They were advised to seek independent legal counsel regarding their rights and duties under the Operating Agreement; and

4. They had full opportunity to review and discuss the Operating Agreement with their legal counsel and other advisors

These representations demonstrate that Plaintiffs considered various information before making a sober decision to invest money in a real estate venture and made the investment without being induced by anyone or anything other than the temping return they were going to receive on their investment.

The definitions of a "taking" or an "appropriation" imply that the transfer of possession, dominion of control occurred without consideration. Adhering to the plain meaning rule, "to take" is defined as "to lay hold of; to gain or receive into possession; to seize; to deprive one of the use or possession of; to assume ownership." *Black's Law Dictionary* 1303 (5th ed 1979). "To appropriate" means make a thing one's own." Black's Law Dictionary 93 (5th ed 1979). It is no coincidence that the legislature used those terms to define theft. A person commits theft when "with the intent to deprive another of property or to appropriate property to the person or to a third person, the person ***takes, appropriates, obtains or withholds such property from an owner thereof." ORS 164.015(1) (underline emphasis added). Obviously, in both the theft statute and the **elder** **abuse** statute, the legislature contemplated that where, pursuant to the terms of a contract, good and valuable consideration is given in return for the property, no "taking" has occurred. A taking or an appropriation simply cannot exist where Plaintiffs receive valuable consideration.

Here, the Operating Agreement clearly sets forth the valuable consideration Plaintiffs received in exchange for their contribution to Covenant - a 50% membership interest. If things went as planned, Plaintiffs would have quadrupled their investment (the Keystone property was valued as high as $32 million, depending on its use). As it turned out, the receipt of such consideration places Plaintiffs in the shoes of nearly every disappointed real estate investor. It does not, however, place Plaintiffs in the shoes of an exploited victim like Church, In Church, the plaintiff did not receive any consideration for her transfer of money and

 © 2016 Thomson Reuters. No claim to original U.S. Government Works.

property to the defendant, leading the court to conclude that a "taking" occurred and that it was "wrongful." Church, 190 Or App at 118.

Simply put, Plaintiffs' reliance on Hudler's representations or advice, if any, in making their investment does not constitute a "taking" within the meaning of the statute. Since Plaintiffs cannot prove that there was a "taking" of their property within the meaning of the statute, they cannot maintain a claim for **elder** **abuse**.

b. Hudler's Involvement with Plaintiffs' Investment in Covenant was not "Wrongful."

In *Church,* the court also analyzed the fourth element of a financial **abuse** claim. Turning again to the dictionary, the court defined "wrongful" as "full of wrong: INJURIOUS, UNJUST, UNFAIR." *Church* at 118. The court went on to state that conduct is "wrongful" if "it is carried out in pursuit of an improper motive or by improper means" and that improper means include "violence, threats, intimidation, deceit, misrepresentation, bribery, unfounded litigation, defamation and disparaging falsehood." *Id.* Finally, the court reasoned that the "dual meaning of the word 'wrongful,' focusing alternatively on the defendant's motives or the means by which property was taken, is sensible in the context of the financial **abuse** statues. *Id.* at 119.

Once again, Plaintiffs have not produced any evidence that their investment in Covenant was caused by some wrongful act of Hudler. Taking first the means by which Plaintiffs invested in Covenant, the Operating Agreement, the sole document outlining the terms and conditions of Plaintiffs investment in Covenant, speaks for itself. It evidences the fact that Plaintiffs are sophisticated investors aware of the risks associated with real estate investments. Specifically, the "Investment Representations" set forth above prove that Plaintiffs were advised to seek independent legal counsel in order to evaluate these risks. The plain language of the Operating Agreement itself contradicts any contention that such a document would constitute an improper means sufficient to satisfy the "wrongful" element of financial **abuse** claim.

More importantly, Plaintiffs retained complete and ultimate control over their investment. Plaintiffs had veto over all managerial decisions made by Bridgeport or Hudler, including decisions about admitting new members, amending LLC documents, changing the nature of the business, merger, distributions, dissolution, setting member and manager compensation, appointing and removing manager, and transferring voting rights, to name a few. See Exhibits 34-37 to Scruggs Aff; see also the discussion on "security" in Section III above for a complete list of Plaintiffs' powers. In addition, Plaintiffs had the right to access important company information, enabling them to wield their voting rights in an educated manner. Id. Simply put, Plaintiffs had the power and the knowledge necessary to oversee and protect their investment. The fact that Hudler agreed to entrust that kind of power to Plaintiffs necessarily negates the allegation that he acted by improper means.

Taking the second prong of the analysis. Plaintiffs have not produced any evidence that their investment in Covenant was a result of Hudler's improper motives. Acting in his capacity as manager of Bridgeport, Hudler, like Plaintiffs, was a member of Covenant, bound by the very same terms and conditions of the Operating Agreement. It can be assumed that both parties were motivated by the prospective returns from their venture together. In fact, as discussed above, Plaintiffs received valuable consideration in exchange for their contribution to Covenant - a 50% membership interest. With that ownership interest, Plaintiffs could have quadrupled their investment, which is what motivated Plaintiffs. Plaintiffs' contention that because such investments did not produce the desired results, Hudler's motives behind inviting Plaintiffs to invest in Covenant were improper, is simply not supported by the evidence. Since Plaintiffs cannot establish that Hudler's actions were "wrongful," he is entitled to summary judgment on Plaintiffs' **elder** **abuse** claim.

V. DERIVATIVE CLAIM FOR BREACH OF FIDUCIARY DUTY:

Plaintiffs own a 50% interest in Covenant and bring this action on Covenant's behalf.[7] Plaintiffs allege that Covenant was injured by the malfeasance of its managing member, Bridgeport. Specifically, Plaintiffs allege that Bridgeport breached its fiduciary duties to Covenant and such breach caused harm to Covenant. Besides Bridgeport, Plaintiffs are suing Bridgeport's

employees—Hudler and Markley—on the theory of joint liability in tort. Apparently, Plaintiffs believe Hudler and Markley acted in concert with Bridgeport to damage Covenant. Plaintiffs' derivative claim fails as a matter law because (1) Plaintiffs failed to make a pre-litigation demand on Bridgeport; and (2) Hudler and Markley cannot be held jointly liable with Bridgeport for Bridgeport's allegedly wrongful conduct.

a. Plaintiffs' derivative claim fails as a matter of law because they admittedly failed to make a pre-litigation demand on Bridgeport communities.

A shareholder derivative suit is an action brought by an individual shareholder to remedy an injury done to the corporation by a third party or by an officer, director, or controlling shareholder of the corporation. *Kamen v. Kemper Fin. Servs.,* 500 US 90, 95 (1991); *Shoen v. SAC Holding Corp.,* 122 Nev 621, 633, 137 P 3d 1171, 1179 (2006). The sole purpose of a derivative suit is to vindicate a wrong done to the corporation; as such, the cause of action belongs to the corporation, not to the named plaintiff. *See Noakes v. Schoenborn,* 116 Or App 464, 471 (1992); *see Nelson v. Sierra Const. Corp.,* 77 Nev 334, 341, 364 P 2d 402, 405 (1961).

Because the cause of action belongs to the corporation, any plaintiff who wishes to file a derivative suit must first give the corporation an opportunity to act on its own behalf.[8] *See Shoen, supra,* 122 Nev at 633. Specifically, "because the power to manage the corporation's affairs resides in the board of directors, a shareholder must, before filing suit, make a demand on the board, or if necessary, on the other shareholders, to obtain the action that the shareholder desires." *Id.* (underline emphasis added); NRS 86.483; NRS 86.487. This demand requirement recognizes the corporate form in two ways: first, a demand informs the managers of the shareholder's concerns and gives them the opportunity to take corrective action; and second, the demand requirement discourages unnecessary, unfounded, or improper shareholder actions. *Shoen, supra,* 122 Nev at 633. Thus, a shareholder has standing to bring a derivative action only if the corporation's managers have refused to bring the action or if the effort to cause the managers to bring the action "is not likely to succeed." NRS 86,483. Failure to comply with the pre-litigation demand requirement is grounds for dismissing a derivative suit. *See Shoen, supra,* 122 Nev at 634 ("a shareholder's failure to sufficiently plead compliance with the demand requirement deprives the shareholder of standing and justifies dismissal of the complaint"). The complaining shareholder must make a pre-litigation demand even if he alleges that the managers participated in the wrongful act. *Id.* at 636.

Nevada law imposes a heightened pleading standard on a plaintiff seeking to avoid the pre-litigation demand requirement. *Id.* at 633. That is, "a derivative complaint must state, with particularity, the demand for corrective action that the shareholder made on the board of directors (and, possibly, other shareholders) and why he failed to obtain such action, or his reasons for not making a demand." *Id.* at 633-34; NRCP 23.1[9]; NRS 41.520(2). While the shareholder is not required to plead evidence, "mere conclusory assertions will not suffice under NRCP 23.1's 'with particularity' standard." *Id.* at 634. Absent particular allegations, a derivative complaint does not adequately plead demand futility and cannot survive a motion to dismiss. *Id.*

Here, Plaintiffs admit that they never made a pre-litigation demand: "Plaintiffs have not made demand on defendants to bring this derivative action because such demand would be futile, as it would require defendants to sue themselves." Complaint, ¶61. For this reason alone, as a matter of law, Plaintiffs have no standing to bring a lawsuit for derivate active and Hudler is entitled to summary judgment.

Furthermore, Plaintiffs are wrong that a pre-ligation demand would not require Hudler and Markley to sue themselves. Bridgeport - not Hudler or Markley - is the managing member of Covenant and any pre-litigation demand should have been made on Bridgeport (not Hudler or Markley). Thus, contrary to Plaintiffs' allegation, a demand on Bridgeport would not have required Bridgeport Communities to sue itself. Rather, the demand would have asked Bridgeport to sue Hudler and Markley. As such, the basis for Plaintiffs' claim of demand futility is factually erroneous and cannot excuse their failure to make a demand on Bridgeport. Since Plaintiffs admittedly failed to make a pre-litigation demand on Bridgeport and such failure cannot be

legally excused, Plaintiffs' derivative claim for breach of fiduciary duty fails as a matter of law. Therefore, Hudler is entitled to summary judgment.

b. Plaintiffs' theory of joint liability does not save their derivative claim because they failed to allege any wrongful conduct by Hudler that would trigger the Granewich rule

Plaintiffs attempt to salvage their defective derivative claim by including a bare allegation that Hudler and Markley, as employees of Bridgeport can be held personally liable for Bridgeport's tortious conduct on a theory of joint liability in tort. Plaintiffs' argument fails as a matter of law.

As a general rule, a corporation's managers are not personally liable for torts committed by the corporation merely by virtue of their office. ORS 63.165(1); *Pelton v. Gold Hill Canal Co.,* 72 Or 353, 358-59 (1914). Personal liability, if any, must be based on the managers' wrongful, tortious, or fraudulent conduct independent of their status as employees of the corporation. Pelton, 72 Or at 358-59; *see also Creditors Protective Assn. v. Balcom,* 248 Or 38 (1967). Without this safeguard, corporate managers could be held vicariously liable for the torts of the corporation "without [p]laintiffs having to plead and prove that [the managers] had done anything wrong." Bernards, 229 Or App at 364. Oregon law does not allow this. *Id.*

In a seminal case on this issue, the Supreme Court dealt with the situation where the majority shareholders of a close corporation hired a lawyer to assist them in illegally squeezing out a minority shareholder. *Granewich v. Harding,* 329 Or 47, 52 (1999). The conduct of the majority shareholders constituted a breach of fiduciary duty to the minority shareholder and, as a result, the minority shareholder sued the majority shareholders on that ground. *Id.* at 50, 51. However, in the same action, the minority shareholder also brought a claim against the lawyer for joint tort liability. *Id.* The issue before the court was whether the allegations of the minority shareholder's complaint sufficiently stated a claim against the lawyer. *Id.* at 53.

Before even considering the allegations in the complaint, the court necessarily ruled that the doctrine of joint tort liability exists in Oregon. Id. at 53-54. That is, a third party can be held jointly liable with a tortfeasor where the third party (1) performs a tortious act in concert with the tortfeasor, or (2) knowingly provides substantial assistance to the tortfeasor In the commission of his tort. Id. at 55. As with the Pelton rule stated above, the Granewich rule is not a rule of vicarious liability. Liability of a third party for the conduct of a tortfeasor depends on pleading and proving that the third party wrongfully or tortiously aided, abetted, or substantially assisted the actual tortfeasor. *See id.* at 53-54.

In Granewich, the court held that the minority shareholder's complaint adequately alleged a claim for joint tort liability. *Id.* at 60. In so ruling, the court noted that the minority shareholder alleged several ways in which the lawyer's conduct wrongfully caused or contributed to the minority shareholder's injury. *Id.* at 59. For example, the minority shareholder alleged that the lawyer willingly and knowingly entered into a contract with an unlawful purpose (breaking state law). *Id.* The minority shareholder also alleged that the lawyer "undertook multiple unlawful steps" to further that purpose, such as (1) drafting letters to the minority shareholder that contained knowingly false statements of law; (2) providing legal advice to the majority shareholders on how to breach its fiduciary duties; and (3) amending the corporation's bylaw's in such a way that enabled the majority shareholders to squeeze out the minority shareholder. *Id.* at 52, 59. Combined, these allegations demonstrated that the lawyer's liability would be based on his own wrongful conduct—i.e., on his "participation with the other defendants in breaching fiduciary duties owed to [the] plaintiff." *Id.* at 60. As such, the complaint adequately stated a cause of action for joint tort liability. *Id.*

Turning to the case at bar, Plaintiffs seek to hold Hudler personally liable for Bridgeport's alleged breach of fiduciary duty on a theory of joint tort liability. As a matter of law, Hudler cannot be personally liable.

First, Plaintiffs can offer no admissible evidence that Hudler and Markley participated in the Bridgeport's purportedly tortious conduct. Oregon law requires Plaintiffs to prove that Hudler wrongfully aided, abetted, encouraged, acted in concert with, or gave substantial assistance to Bridgeport. In short, Plaintiffs must produce evidence of Hudler's wrongful conduct, *Pelton,* 72 Or at 358; *see Granewich,* 329 Or at 59. Plaintiffs cannot do this. Plaintiffs' Complaint includes absolutely no description or

WestlawNext © 2016 Thomson Reuters. No claim to original U.S. Government Works.

a single instance of wrongful conduct on the part of Hudler. In stark contrast to the *Granewich* complaint, Plaintiffs' proposed derivative claim is completely silent on the subject of *how* Hudler substantially assisted Bridgeport Communities. Plaintiffs' failure is dispositive and Hudler is entitled to summary judgment.

Second, Plaintiffs appear to base their theory of joint tort liability entirely on Hudler's status as a managers - i.e., employee - of Bridgeport. Plaintiffs offer one specific allegation as to Hudler: “defendants [were] managers of Bridgeport Communities, which in turn was the manager of Covenant Nevada.” Complaint 1157. This allegation - used in the context of Plaintiffs' derivative claim - comes dangerously close to an allegation that Hudler ought to be held vicariously liable for Bridgeport's alleged tortious conduct based solely on his status as a manager. If Plaintiffs intend to make that argument, Oregon law rejects it. ORS 63.165(1); Pelton, 72 Or at 358; see also Bernards, 229 Or App at 364. To hold Hudler liable on a theory of joint tort liability, far more is required. Plaintiffs must prove by the preponderance of the evidence that Hudler, independent of his status as a manager, wrongfully participated in the Bridgeport's tortious conduct. Because Plaintiffs can offer not a single piece of evidence on this point, Plaintiffs' claim for joint tort liability fails as matter of law and Hudler is entitled to summary judgment in his favor.

CONCLUSION

For the foregoing reasons, Hudler is entitled to summary judgment or partial summary judgment with respect to each of Plaintiffs' claims against him.

DUNN CARNEY ALLEN HIGGINS & TONGUE LLP

Jay R. Chock, OSB No. 830043

E-Mail: jchock@dunncarney.com

Irene A. Scruggs, OSB No. 065030

E-Mail: iscruggs@dunncarney.com

Attorneys for Defendant Hudler Trial Attorney: Jay R. Chock

Footnotes

1 Although Hudler denies making these representations, he does not dispute their existence for the purpose of this motion. Hudler reserves the right to raise any and all arguments at trial and this filing should not be construed as a waiver of any defenses to Plaintiffs' claims.

2 Hudler asks the court to take judicial notice of this well known fact

3 ORS 59.135 is Oregon's primary securities fraud statute and contains the general prohibition against fraud in connection with the sale of a security. By contrast, ORS 59.115 and ORS 59.137 are enforcement statutes—i.e., they provide purchasers a right to remedy violations of ORS 59.135. Of these two statutes, ORS 59.115 provides the civil remedy to a purchaser of securities. See Held v. Product Mfg. Co., 286 Or 67, 71, 592 P2d 1005 (1979).

4 Oregon's definition of “investment contract” is derived from federal case law interpreting the same term as it appears in federal securities fraud statutes. In particular, the *Pratt* court adopted the definition of “investment contract” from *S.E.C. v. W. J. Howey Co.,* 328 US 293, 298 (1946) as modified by *United Housing Found., Inc. v. Forman,* 421 US 837, 852 (1975). Because the state and federal definitions are virtually identical, Oregon courts are permitted to rely on federal cases when deciding whether or not a particular transaction fits within the definition of “investment contract.” *Computer Concepts,* 310 Or at 714 n 7.

5 The implied right of veto is born from the Operating Agreement's requirement that the members consent to certain managerial decisions before those decisions become effective. See, e.g., Ex. 1 to Scruggs Aff. (Section 5.3). The Operating Agreement states that, for such decisions, more than 50% of the membership must vote to approve or reject the proposed action. See id. (Section 5.1). Here, there are only two members—Plaintiffs and Bridgeport Communities—each with a 50% interest in Covenant Partners, LLC. See id.

(Section 3.1). Thus, no managerial action requiring member consent may be taken without Plaintiffs' express consent. Otherwise, the required percentage of membership approving the action can never be reached.

6 The express right of veto is based on sections of the Operating Agreement that expressly require unanimous consent of all members before a proposed managerial decision becomes effective. *See, e.g., id.* (Section 5.4). The express right of veto is also found in other sections of the operating agreement that grant Plaintiffs by name, the right to reject proposed managerial decisions. *See id.* (Section 5.20).

7 Hudler notes that Plaintiffs have named Covenant Partners, LLC as a defendant instead of Bridgeport Communities, LLC. Hudler assumes that this is an error and Plaintiffs meant to name Bridgeport Communities, LLC as the defendant.

8 Hudler cites Nevada authority in this section because Covenant Partners, LLC is a Nevada Corporation and, pursuant to the First Restated Operating Agreement, all disputes arising out of the Operating Agreement, must be governed by the law of the *State of Nevada.* For the records, however. Nevada law on pre-litigation demands is virtually identical to Oregon.

9 NRCP 23.1 provides, in pertinent part, that “[t]he complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for plaintiff's failure to obtain the action or for not making the effort.”

End of Document

© 2016 Thomson Reuters. No claim to original U.S. Government Works.