

**NONPRECEDENTIAL**

**IN THE DISTRICT COURT OF THE VIRGIN ISLANDS  
DIVISION OF ST. THOMAS AND ST. JOHN**

HANS JORG TENGG, *et al.*, )  
)  
Plaintiffs )  
)  
v. )  
)  
NORBERT STEGER, HELGA STEGER, )  
MAIER & MARTSCHITSCH, INC. d/b/a )  
MAIER & MARTSCHITSCH )  
CARIBBEAN DEVELOPMENT )  
CONSULTING, INC., CARET BAY )  
DEVELOPMENT, INC., WHALE WATCH,)  
INC., MATTHEW J. DUENSING, and )  
JAMES A. CASNER, III, )  
)  
Defendants )  
)  
\_\_\_\_\_ )

CIVIL NO. 2001/0137

ATTORNEYS:

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*Attorney for Defendants Caret Bay Development, Inc. and Whale Watch, Inc.*

## MEMORANDUM OPINION

**Finch, C. J.**

This matter comes before the Court on the motion of Defendants Matthew Duensing and A. James Casner, III to dismiss Plaintiffs' Complaint. For the reasons expressed herein, Defendants' motion will be denied.

### **I. Background**

The facts according to Plaintiffs are as follows. Defendant Norbert Steger, Plaintiffs' longtime friend, associate and fellow Austrian, contacted Plaintiffs in 1995 regarding an opportunity to invest in a real estate development project at Caret Bay, St. Thomas. Plaintiffs claim that Steger represented himself to be knowledgeable about Virgin Islands real estate, namely its market and rental values, and stated that the project was designed to construct luxury condominiums/villas whose rental income would pay for Plaintiffs' investment. Based on those representations, Plaintiffs entered into a contract with Steger and Maier & Martschitsch, d/b/a Maier & Martschitsch Caribbean Development Consulting, Inc., ("M&M"), a Virgin Islands corporation.<sup>1</sup>

In 1996, Steger introduced the Plaintiffs to two local attorneys, Defendants Duensing and Casner (collectively "Defendants").<sup>2</sup> Plaintiffs hired Defendants to represent them for purposes

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<sup>1</sup>According to Steger, M&M was an independent development company. Plaintiffs allege, however, that M&M was in fact owned by Steger.

<sup>2</sup>For purposes of the instant motion and because the motion is brought by two defendants, the Court here refers to only defendants Duensing and Casner by its reference to "Defendants."

of the real estate investment. According to Plaintiffs, Defendants failed to disclose that they also represented Steger and M&M in the same transaction. Defendants allegedly continued to represent all the parties through the sale of the villas to Plaintiffs in 1999. After the closing, Plaintiffs discovered that the villas were not constructed in accordance with the contract and further discovered the dual nature of Defendants' representation.<sup>3</sup> On March 14, 2001, Plaintiffs sued Steger, M&M and Defendants for, *inter alia*, violating Section 10b of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j and Rule 10b-5, breach of contract, loss of investments and profits, breach of fiduciary duty, and legal malpractice. On September 26, 2001, Defendants moved to dismiss the Complaint.

## II. Standard Governing a Rule 12(b)(6) Motion to Dismiss

\_\_\_\_\_ In determining a Rule 12(b)(6) motion to dismiss, "the material allegations of the complaint are taken as admitted," and the Court must liberally construe the Complaint in Plaintiff's favor. Jenkins v. McKeithen, 395 U.S. 411, 421 (1969) (citing Fed. R. Civ. P. 8(f) and Conley v. Gibson, 355 U.S. 41 (1957)). All reasonable inferences are drawn in favor of Plaintiff. Sturm v. Clark, 835 F.2d 1009, 1011 (3<sup>rd</sup> Cir. 1987). Further, the Court must follow "the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Conley, 355 U.S. at 45-46; Piecknick v. Commonwealth of

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<sup>3</sup>Plaintiffs also allege that Defendants failed to inform them that the sales price exceeded the market value, that the rental projections were overestimated, and that no profits would ever be realized. (Compl. at ¶¶ 44, 57.) They also allege that Defendants advised them to set up local corporations to own the villas and improperly charged them for transfer stamp taxes and costs allocated at the closing. (Id. at ¶¶ 28, 30, 31, 46, 49, 57.)

Pennsylvania, 36 F.3d 1250, 1255 (3<sup>rd</sup> Cir. 1994). The Rule 12(b)(6) motion is viewed with disfavor and rarely granted. 5A Charles Alan Wright & Arthur Miller, FEDERAL PRACTICE AND PROCEDURE § 1357 at 321 (West 1990).

### **III. Analysis**

Defendants raise three grounds on which to dismiss Plaintiffs' Complaint. First, they argue that the sale of the villas does not constitute a security for purposes of the Exchange Act. Second, they contend that Plaintiffs have failed to meet the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA" or "Act"), 15 U.S.C. § 78u-4. Finally, they assert that Plaintiffs have failed to plead the necessary scienter for a securities fraud claim. Analysis of each argument follows in turn.

#### **1. Whether the Sale of the Villas Constituted a Security**

Defendants argue that Plaintiffs' Complaint is devoid of any reference to the purchase or sale of securities and, thus, the transaction does not fall under the Exchange Act. The crux of Defendants' argument is that the purpose of the investment was residential. See United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852-53 (1975) (noting that a contract to purchase residential or recreational property "when a purchaser is motivated by a desire to use or consume the item purchased" does not come within the realm of securities law). Defendants note in this regard that Plaintiffs' Complaint is couched in language referring to (1) an investment in "real estate," and (2) the closing on Plaintiffs' "homes." (Compl. at ¶¶ 38-39, 49.) This argument,

however, is unpersuasive.

The transaction at issue resembles an investment contract, which is a type of security under the Exchange Act. See 15 U.S.C. § 78c(a)(10). The Supreme Court has defined an investment contract as

a contract, transaction, or scheme whereby a person invests his money in (1) a common enterprise and is led to (2) expect profits (3) solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946). The Securities Exchange Commission (“SEC”) itself has stated that an offering of condominium units may constitute a security offering if it involves:

(1) both a rental arrangement and sales emphasis on the economic benefits to the purchaser from the managerial efforts of the promoter or third parties; (2) a rental pool arrangement; or (3) material restrictions on the owner’s occupancy or rental of his unit, such as a requirement for making the unit available for rental for part of the year or a requirement for using an exclusive rental agent.

SEC Release No. 33-5347, 38 Fed. Reg. 1735, 1736 (Jan. 18, 1973), *cited in* Cameron v.

Outdoor Resorts of Am., Inc., 608 F.2d 187 (5th Cir. 1979); see also Hodges v. H&R

Investments, Ltd., 668 F. Supp. 545, 549-50 (N.D. Miss. 1987). Based on Plaintiffs’ pleadings, it

is apparent that they joined a common enterprise with an expectation of future rental income and

that the villa complex was to be professionally managed. (Compl. at ¶¶ 16, 18-19, 34; Pls.’

Opp. to Mot. to Dismiss at 10-11.) Thus, under the Howey test stated above and the SEC

guidelines, Plaintiffs investment in the villa association in this case constituted an investment

contract and thus constituted a security. Defendants’ motion as it pertains to this argument will

be denied.

## **2. Pleading Requirements of the Private Securities Litigation Reform Act**

Defendants next contend that Plaintiffs' pleadings fail to meet the requirements of the PSLRA. In enacting the PSLRA, Congress mandated that a class complaint alleging securities fraud "shall, with respect to each act or omission . . . 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). The Act "requires plaintiffs to plead 'the who, what, when, where, and how' of each act or omission giving rise to a fraudulent state of mind or 'scienter'." Gigliotti v. Mathys, 129 F. Supp. 2d 817, 820 (D.V.I. 2001) (citations omitted). This standard for pleading scienter heightens the scienter standard from that in other fraud claims, which under Fed. R. Civ. P. 9(b) only requires that scienter be "averred generally." See Fed. R. Civ. P. 9(b).

Defendants' attempt to impose the higher pleading standard in this case, however, is misguided in that the instant suit is not the type of action that PSLRA was designed to prevent. Section 78u-4 of the Act specifically states that "[t]he provisions of this subsection shall apply in each private action arising under this title . . . that is brought as a *plaintiff class action* pursuant to the Federal Rules of Civil Procedure." 15 U.S.C. § 78u-4 (emphasis added). Whereas the instant matter is not a class action, the requirements of the PSLRA are inapplicable and Plaintiffs need only plead scienter generally.

## **3. Whether Plaintiffs Have Pled Scienter Sufficiently**

To state a claim under Section 10(b) of the Exchange Act and Rule 10b-5, Plaintiffs must plead the following elements: (1) that the Defendants made misstatements or omissions of

material fact; (2) with scienter; (3) in connection with a purchase or sale of securities; (4) upon which the Plaintiffs relied; and (5) Plaintiffs' reliance was the proximate cause of their injury.

See Kline v. First W. Gov't Sec., Inc., 24 F.3d 480, 487 (3d Cir. 1994); Gigliotti, 129 F. Supp. 2d at 820. As noted above, Plaintiffs must also satisfy the requirements of Fed. R. Civ. P. 9(b) by pleading the facts of the fraud with particularity and pleading scienter generally. See Fed. R. Civ. P. 9(b) ("In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.").

Basing their arguments on the PSLRA's heightened standard for pleading scienter, Defendants contend that Plaintiffs neither plead facts raising a strong inference of scienter nor evidenced that Defendants knowingly and intentionally made any false material statements in connection with the purchase or sale of a security. (Defs.' Mem. of Points and Authorities in Supp. of Mot. to Dismiss at 9; Reply to Pls.' Opp. to Mot. to Dismiss at 16-23.) Whereas it is clear, as stated above, that the PSLRA does not apply in this case, it is also clear that under Rule 9(b) scienter can be established not only by intentional acts and omissions, but by reckless acts as well. The Third Circuit Court of Appeals has stated that reckless conduct involves

[h]ighly unreasonable (conduct), involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

SEC v. Infinity Group Co., 212 F.3d 180, 192 (3d Cir. 2000) (alterations in original) (citations omitted). In their pleadings in the instant case, Plaintiffs have alleged that Defendants failed to disclose a conflict of interest based on Defendants' dual representation of all the parties. It is a

well-accepted premise of the rules of professional responsibility governing attorneys that they must inform their clients of potential conflicts of interest. See ABA Model R. of Prof. Conduct Rule 1.7. Accordingly, at this preliminary stage and drawing all reasonable inferences in Plaintiffs' favor, this Court finds that Plaintiffs have sufficiently pled scienter based upon Defendants' alleged reckless act of failing to disclose a potential conflict of interest.

#### **IV. Conclusion**

In light of the foregoing, the Court finds that Plaintiffs' investment in the villa complex constituted an investment contract for purposes of the Exchange Act. Whereas the pleading requirements of the PSLRA are inapplicable to the instant case, and whereas Plaintiffs have adequately pled the elements of securities fraud, Defendants' Motion to Dismiss the Complaint is denied. An appropriate Order is attached.

**ENTER:**

**Dated:** October \_\_\_\_, 2002

\_\_\_\_\_  
**RAYMOND L. FINCH**  
**CHIEF U.S. DISTRICT JUDGE**

**Attest:**  
Wilfredo F. Morales  
Clerk of the Court

**By:** \_\_\_\_\_  
**Deputy Clerk**

cc: Honorable Geoffrey Barnard, U.S. Magistrate Judge  
Lee J. Rohn

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