THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

THE U.S. SMALL BUSINESS ADMINISTRATION, as Receiver for Acorn Technology Fund, L.P.	:	CIVIL ACTION
Plaintiff,	:	NO. 03-5982
v.	:	
RICHARD D. PROPPER, et al.,	:	
Defendants.	:	

MEMORANDUM

Giles, C.J. November 17, 2004

I. Introduction

By its Order of January 17, 2003, this court placed Acorn Technology Fund, L.P.[1] ("ATF") in Receivership and appointed the United States Small Business Administration ("SBA") as Receiver. Pursuant to powers granted under the Receivership Order, the SBA undertook the task of marshaling the assets of ATF and conducting all business affairs of ATF. This included making written demand upon certain limited partners of ATF for arrearages on investor agreements.[2] On October 29, 2003, after the Defendants failed to meet their contractual

[1] ATF is a New Jersey limited partnership pursuant to the Certificate of Limited Partnership filed with the Secretary of State of New Jersey on September 29, 1997.

[2] The total amount demanded by the SBA from Defendants is $1,764,333. The following are the individual arrearage amounts per defendant(s):

- Acorn Connecticut Investments, L.P. and Daniel Beharry: $670,000
- Kenneth Borow: $25,000
- Michael Chermak: $100,000

obligations, the SBA, in its capacity as Receiver for ATF, brought separate actions against eight individual defendants and one corporate entity alleging breach of contract. The court consolidated all the cases on January 27, 2004. In response to the SBA's demands, all defendants filed answers, affirmative defenses and counterclaims against both ATF and the SBA. The Defendants allege claims for fraud in the inducement against ATF and negligence against the SBA. Before the court is the SBA's Motion to Dismiss Defendants' Counterclaims. For the reasons that follow, SBA's Motion to Dismiss is granted.

II. Background

After being courted as potential investors by John Torkelsen, president and manager of Acorn Technology Partners, L.L.C. ("ATP"), the general partner of ATF, the Defendants entered into investment agreements ("Subscription Agreements") for a partnership interest in ATF. In the Subscription Agreement**,** each defendant contracted to purchase a limited partnership interest in ATF and to make certain capital contributions to the partnership. (Subscription Agreement § 1.1).

Each defendant was notified and acknowledged, by signature to the Subscription Agreement, that the terms of the limited partners' investment in, and rights regarding, ATF were governed by the Partnership Agreement between ATF and ATP as well as the Information Memorandum. Specifically, in section 2.1(a) of the Subscription Agreement, each investor

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- Timothy Garton: $26,000
- William Lerach: $750,000
- Kerry Propper: $25,000
- Richard Propper: $128,333
- Charles Smith: $40,000

acknowledged, represented, and warranted that:

> Investor has received and carefully read the Partnership Agreement and Memorandum, and is fully familiar with and understands the contents thereof. Investor confirms that no representations or warranties have been made to Investor regarding the Partnership or the Interests and that Investor has not relied upon any such representation or warranty that is not contained in the Partnership Agreement and/or Memorandum in making the subscription. Investor has based its decision to subscribe for the Interests solely on the information contained in the Offering Memorandum[.]

The Introduction (§ 1) to the Information Memorandum stated that ATF is "a venture capital limited partnership" which "intends to invest in domestic, high growth, emerging companies in the information technology and telecommunications sectors." The Memorandum also explained to potential investors that ATF "expects to participate in the Small Business Investment Company ("SBIC") program run by the U.S. Small Business Administration ("SBA")." While the Memorandum was clear that it was the intention of ATF to apply for a SBIC license, it also disclosed to investors that "there is no assurance that a license will be granted" and that in the event that ATF "does not operate as an SBIC, it will operate as a conventional venture capital fund."

On or about June 25, 1998 ATF submitted its application for an SBIC license to the SBA. A year later, on June 25, 1999, ATF was licensed by the SBA as a SBIC. When ATF was placed in Receivership on January 17, 2003, the Receiver, SBA, was "appointed for the purpose of continuing the operations of [ATF], including without limitation, managing [ATF]'s portfolio of investments, satisfying the claims of creditors and the sale of assets in the ordinary course of business, and defending and pursuing claims and causes of actions available to [ATF], as warranted." ATF, under the SBA's control, has continued to operate as a SBIC.

III. Standard for Motion to Dismiss

Dismissal of a complaint pursuant to Rule 12(b)(6) is proper "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." Hishon v. King & Spalding, 467 U.S. 69, 73 (1984). The court must accept all of plaintiff's allegations as true and draw all reasonable inferences therefrom. See Jenkins v. McKeithen, 395 U.S. 411, 421 (1969) ("the material allegations of complaint are taken as admitted"); Holder v. City of Allentown, 987 F.2d 188, 194 (3d Cir. 1993) ("[a]t all times in reviewing a motion to dismiss we must 'accept as true the factual allegations in the complaint and all reasonable inferences that can be drawn therefrom.'" (quoting Markowitz v. Northeast Land Co., 906 F.2d 100, 103 (3d Cir. 1990))).

IV. Discussion

In their counterclaims, Defendants allege that they are entitled to rescission of their subscription agreement with ATF, as well as a return of all investments, on the theory that they were fraudulently induced to enter into their contracts with ATF**.** Defendants argue that ATF, controlled and operated by Wood Tate, John Torkelsen, his wife and son ("the Torkelsens") and its general partner ATP, intended from the outset to engage in fraudulent activity which would violate the rules and regulations applicable to SBICs. In its Motion to Dismiss the Defendants' Counterclaims, the SBA argues that rescission and the return of Defendants' investment are not the proper remedy. Because the court finds that the claims asserted by the Defendants against ATF are derivative in nature, thereby dismissing Defendants' claims for fraudulent inducement, it does not reach the issue of proper remedy.

A. Defendants Claims Against ATF Are Derivative in Nature

Before the court are claims by individual limited partners (Defendants) asserted against the limited partnership to which they belong (ATF). As a suit by limited partners against the partnership, the court must first determine whether the alleged injuries to the Defendants are individual in nature, such that they may be brought directly by the limited partners against the partnership, or if the injuries are primarily to the partnership or the body of the limited partners and must be brought derivatively.

ATF is a New Jersey limited partnership governed by the laws of the State of New Jersey. In 1985, New Jersey adopted the Uniform Limited Partnership Act of 1976 ("ULPA"). Since its inception, the ULPA has recognized the right of limited partners to bring direct suits against the partnership to enforce the limited partner's own rights or liability. See Uniform Limited Partnership Act § 26 (holding that a limited partner "is not a proper party to a proceeding by or against the partnership, except where the object is to enforce a limited partner's right against or liability to the partnership."). In 1976, the revised ULPA added a provision to allow limited partners to bring derivative suits against the partnership or general partners when the general partners refused, or could reasonably be expected to refuse, to bring an action on behalf of the partnership. See Uniform Limited Partnership Act § 1001. New Jersey, like many other jurisdictions, adopted § 1001 of the revised ULPA, which provides:

> A limited partner may bring an action in the right of a limited partnership to recover a judgment in its favor against one or more general partners, former general partners, limited partners, or third parties, if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed. N.J. Stat. Ann. § 42:2A-62.

No New Jersey court has considered the rights of limited partners to sue the limited partnership. Therefore, this court will, like New Jersey courts, look to other jurisdictions which have adopted the ULPA. See Seventy-Three Land, Inc. v. Mazlar Partners, 637 A.2d 202, 203 (N.J. Super. Ct. App. Div. 1994) (finding that issues not resolved by any New Jersey court opinion, which have been treated by other jurisdictions that have adopted the ULPA, may be regarded as authority). In resolving whether the Defendants' claim is direct or derivative in nature, this court finds persuasive the reasoning of other jurisdictions which have analogized the position of limited partners as investors to that of corporate shareholders. See e.g. Kline Hotel Partners v. Aircoa Equity Interests, Inc., 708 F. Supp. 1193, 1195 (D. Colo. 1989) (recognizing the similarity of limited partners and shareholders to apply general principles of corporate law to determine whether the plaintiffs claims, brought pursuant to State's version of § 1001 of the ULPA, were direct or derivative in nature); Jaffe v. Harris, 312 N.W.2d 381, 385 (Mich. Ct. App. 1981) (same); Energy Investors Fund, L.P. v. Metric Constructors, Inc., 516 S.E.2d 399, 400-01 (N.C. Ct. App. 1999) (same).

To determine whether a complaint states a direct or derivative cause of action, courts look to the "nature of the wrongs alleged in the body of the complaint, not the plaintiff's designation or stated intention." Strasenburgh v. Straubmuller, 683 A.2d 818, 830 (N.J. 1996). Generally, the distinction between direct and derivative actions depends upon whether the harm alleged by the plaintiff is independent of the harm suffered by the corporation or partnership. HB Gen. Corp. v. Manchester Partners, L.P., 95 F.3d 1185, 1194 (3d Cir. 1996). When a plaintiff alleges harm which she has suffered indirectly, through the partnership, such as a the diminution of the value of her investment, malfeasance by the general partners, waste, or breach of fiduciary, the

claim must be brought derivatively on behalf of the partnership. See Strasenburgh, 683 A.2d at 829-30 (finding diminution in value, waste, and breach of fiduciary to be classically derivative); Kenworthy v. Hargrove, 855 F.Supp. 101, 106 (E.D. Pa. 1994) (noting that malfeasance is the type of derivative action contemplated by Pennsylvania's version of § 1001 of the ULPA). On the other hand, if the plaintiff establishes an injury "separate and distinct" from that suffered by other limited partners, she may proceed against the partnership directly. Strasenburgh, 683 A.2d at 830 (quoting Moran v. Household Int'l, Inc., 490 A.2d 1059, 1070 (Del. 1985)). A classic example of independent harm which should be brought individually is interference with the contractual rights of an investor. Id.

Defendants assert claims of fraudulent misrepresentation, or fraudulent inducement, against ATF based on statements by the Torkelsens, which the Defendants claim were knowingly fraudulent when made and intended to induce reliance by the Defendants to secure their investment in ATF. (Defs.' Mem. In Opp'n to Pl.'s Mot. To Dismiss Countercl. at 3, 10). Fraudulent misrepresentation may be brought directly or derivatively. Golden Tee, Inc. v. Venture Golf Sch., Inc., 969 S.W.2d 625, 632 (Ark. 1998). If the alleged fraud individually induced the investor to enter into the partnership agreement the claim may be brought directly. Id. However, if the alleged fraudulent activity primarily harmed the partnership the claim is derivative. Id. In order to determine whether the claim is direct or derivative in nature, the court must look to the nature of the wrongs alleged rather than the plaintiff's framing of the injury. Strasenburgh, 683 A.2d at 830. See also Golden Tee, 969 S.W.2d at 633 (holding that the purpose of ULPA § 1001 "was not to allow a choice between bringing an individual action or a derivative one," but to permit limited partners to bring derivative actions where appropriate).

In their direct counterclaim against ATF, the Defendants have failed to allege any specific, distinct, or individual injury suffered apart from the partnership itself or the body of limited partners. Defendants' claim that they were induced to invest in ATF based on the representations made by the Torkelsens and ATF's general partner, ATP, that ATF would obtain an SBIC license and operate as such under the rules and regulations applicable to SBICs. (Defs.' First Affirmative Defense ¶ 1). There is no allegation that any specific representations were made to these Defendants by ATF, the Torkelsens, or ATP which were separate and distinct from the general representations made to all potential limited partners contained in the Subscription Agreement and Information Memorandum. Each potential investor, including Defendants, was furnished with copies of the Subscription Agreement, Information Memorandum, and Partnership Agreement before agreeing to become a limited partner in ATF. Upon entering the partnership, through signature to the Subscription Agreement, all limited partners, including Defendants, warranted that they had received and read the Information Memorandum and Partnership Agreement which provided the sole informational basis by which they agreed to subscribe to the ATF limited partnership. All limited partners, including Defendants, warranted through the Subscription Agreement that they had not relied upon any representation or warranty not contained in the informational materials when reaching their investment decisions. Therefore, even if Defendants' allegations that they were fraudulently induced from the outset to enter into the ATF partnership were true, this inducement was not particular to the Defendants, but rather constitutes a fraud perpetrated against the entire body of limited partners and ATF. Therefore, Defendants' claims for fraudulent misrepresentation are derivative in nature, leaving the Defendants without standing to assert their individual claims against ATF.

Had the Defendants brought their claims derivatively, or were given leave by the court to re-plead, the Defendants' allegations would still fail to establish a claim upon which relief could be granted. Defendants have asserted claims for fraudulent inducement against ATF. However, Defendants' claims are exclusively based on the alleged conduct and representations of the Torkelsens and ATP. The proper action under these circumstances would be for the Defendants to bring a derivative suit, on behalf of ATF and the other limited partners, against the Torkelsens and ATP. In this case, however, the Defendants would not be permitted to maintain an action against the Torkelsens and ATP because that is the purpose and function of the court appointed Receiver.

When limited partners sue the limited partnership or its general partners derivatively they are, in essence, standing in the shoes of the partnership to vindicate its rights. See Bankston v. Burch, 27 F.3d 164, 167 (5th Cir. 1994) (finding that in "such derivative lawsuits, the form of the lawsuit does not obscure its substance: it is the partnership's rights, not the limited partner's, that the lawsuit seeks to vindicate.") (emphasis in original). In this case, the SBA, as Receiver for ATF, was appointed for the specific purpose of defending and pursuing any an all claims and causes of action available to ATF. Therefore, the Receiver, on behalf of ATF, is the proper party to bring a derivative action against the Torkelsens and ATP for malfeasance, self-dealing, and fraudulent misrepresentation. See Sunrise Sec. Litigation v. Jacoby, 916 F.2d 874, 887 (3d Cir. 1990) (holding that "the institution or its receiver is the proper party to sue for the benefit of all depositors and creditors"); In re The Landing, 160 B.R. 820, 823 (Bankr. E.D. Mo. 1993) (finding the Trustee to be the proper party to bring an action on behalf of the estate for the benefit of the creditors).

To allow the Defendants to pursue a representative action against the Torkelsens and ATP would also frustrate the efforts and obligations of the Receiver to pursue and preserve all claims belonging to ATF and its limited partners. See Sunrise Sec., 916 F.2d at 888 (holding that allowing the plaintiffs to pursue a derivative action would disrupt "the efforts of the FDIC to recover the institution's assets, which were depleted by defendants' mismanagement and wrongdoing, for equitable distribution among all depositors and creditors in accordance with the federal priority scheme.") (emphasis in original); Partnership Equities, Inc. v. Marten, 443 N.E.2d 134, 136 (Mass. App. Ct. 1982) (refusing to allow limited partners to terminate their contractual obligations to make contributions to the partnership because such action would frustrate the partnership's ability to continue as an ongoing entity). Furthermore, a derivative action by the Defendants is unnecessary, and potentially duplicative, given the pending criminal investigation by the United States Department of Justice against John Torkelsen regarding the alleged illegal activities associated with his management of ATF and ATP. See Kenworthy, 855 F. Supp. at 107 (holding that limited partners lack standing to pursue derivative actions given that the general partners were already acting to protect the interests of the partnership).

Defendants have not established an injury separate and distinct from that suffered by ATF or the body of limited partners. Therefore, Defendants lack standing to bring a direct action against ATF for fraudulent misrepresentation. To the extent Defendants had standing to assert a derivative action against the Torkelsens and ATP for fraudulent inducement, the Defendants are not the proper plaintiffs for this action, because that is the charge given to the court appointed Receiver.

B. Defendants' Negligence Claim Against SBA is Barred by the Federal Tort Claims Act, 28 U.S.C. § 2680

The Defendants also assert a negligence counterclaim against the SBA. Defendants claim that as limited partners of ATF they justifiably relied upon the oversight function of the SBA to ensure that ATF, as a SBIC, was complying with the required rules and regulations applicable to SBICs. (Defs.' Mem. In Opp'n to Pl.'s Mot. To Dismiss Countercl. at 2-3). Defendants maintain that the SBA failed to perform this function adequately and is liable to Defendants for the harms suffered as a result of its negligence. (Id.) The SBA responds that it is not a proper party to this action given its sole capacity as Receiver for ATF. (Mem. Of Law in Supp. Of the Receiver's Mot. To Dismiss Defs.' Countercl. at 11). The court finds that the Defendants' negligence claim against the SBA is barred by the "discretionary function" exception of the Federal Tort Claims Act ("FTCA"), 28 U.S.C. § 2680, requiring dismissal of Defendants' counterclaim.

Pursuant to the "sue or be sued" clause of the Small Business Act, 15 U.S.C. § 634(b)(1), the SBA, as a government agency, enjoys qualified immunity to suits brought against it by private parties. However, claims for monetary damages initiated against a federal agency, which sound in tort, are cognizable exclusively under the Federal Tort Claims Act. 28 U.S.C. § 2679(a). See J.C. Driskill, Inc. v. Abdnor, 901 F.2d 383, 386 (4th Cir. 1990) (holding that "the express authority in section 634(b)(1) for the SBA to sue and be sued permits an award of damages, but does not supplant the status of the FTCA as the sole avenue of relief for tort claimants against the government and its agencies."); DiFillippo v. Quaker State Certified Dev. Co., Inc., CIV.A. No. 87-0074, 1987 WL 11221, at *2 (E.D. Pa. May 19, 1987) (finding that

"whenever the claims are tort claims the exclusive remedy for such claims is pursuant to the Federal Tort Claims Act").

When bringing a cause of action in tort for money damages against a federal agency, the FTCA requires plaintiffs to file an administrative claim before commencing an action in the district courts. 28 U.S.C. § 2675(a). See Chekroun v. Small Bus. Admin., 32 F. Supp. 2d 514, 515 (D. Conn. 1998) ("FTCA causes of action may be brought into a federal court only if 'the claimant shall have first presented the claim to the appropriate federal agency and his claim shall have finally denied by the agency'"). This jurisdictional requirement, however, is waived when redress is sought through a third-party complaint, cross-claims, or counter-claim. 28 U.S.C. § 2675(a). See also DiFillippo, 1987 WL 11221, at *2 (ruling that plaintiff was not required to present administrative claim to the appropriate federal agency because his third-party complaint qualified as an exception under section 2675(a)). Given that the Defendants have asserted their negligence claim against the SBA as a counter claim, this jurisdictional barrier does not apply.

Nevertheless, the court lacks subject matter jurisdiction over the Defendants' negligence claim because the SBA's alleged failure to oversee the management and functioning of ATF adequately is governed by the "discretionary function" exception of the FTCA. Although the FTCA generally waives sovereign immunity with respect to tort claims, this waiver does not extend to claims based on the discretionary functions of government officials. Section 2680(a) of the FTCA provides that the provisions of the chapter shall not apply to:

> (a) Any claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a

> discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.

In determining whether an alleged act or omission is governed by the discretionary function exception, the court looks first to whether the challenged governmental action is a product of judgment or choice. Berkovtiz v. United States, 486 U.S. 531, 536 (1988). If the conduct is a product of judgment or choice, the court then must determine whether the decision was grounded in considerations of public policy. Id. at 537. When looking to the public policy considerations of the agency action "it must be presumed that the agent's acts are grounded in policy when exercising that discretion." United States v. Gaubert, 499 U.S. 315, 324 (1991).

Here, the complained of acts involve the SBA's administrative decisions regarding discovered irregularities at ATF. The SBA's decision when and how to proceed after the SBA discovered irregular activities at ATF, was a decision committed to the sound discretion of the agency. The third circuit has recognized that agency "[d]ecision making as to investigation and enforcement, particularly when there are different types of enforcement action available, are discretionary judgments." Bernitksy v. United States, 620 F.2d 948, 955 (3d Cir. 1980). See also General Pub. Util. Corp. v. United States, 745 F.2d 239, 245 (3d Cir. 1984) ("The extent and scope of an investigation remains a matter of the agency's discretion."); DiFillippo, 1987 WL 11221, at *4 (holding that SBA employee's act of reviewing and approving loan applications was a function not limited to a routine ministerial procedure but was a task that required the exercise of discretion and judgment in determining the appropriateness of a particular loan, which required the consideration of all information in their possession). The Defendants have not

alleged, nor could they, that the SBA has failed to take action regarding the illegal activities of the Torkelsens and ATP. Therefore, their negligence claim rests solely on the question of the timing of the SBA's action. This is a matter squarely within the discretion of the agency and this court cannot engage in judicial second guessing of the SBA's administrative decisions. See Gaubert, 499 U.S. at 323.

V. Conclusion

For the foregoing reasons, the SBA's Motions to Dismiss Defendants' Counterclaims are granted.

An appropriate Order follows.

THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

THE U.S. SMALL BUSINESS	:	CIVIL ACTION
ADMINISTRATION,	:	
as Receiver for Acorn Technology Fund, L.P.	:	
	:	
Plaintiff,	:	NO. 03-5982
	:	
v.	:	
	:	
RICHARD D. PROPPER, et al.,	:	
	:	
Defendants.	:	

ORDER

AND NOW, this 17th day of November, 2004, upon consideration of the Receiver's Motion to Dismiss Defendants' Counterclaims pursuant to Fed. R. Civ. P. 12(b)(6), it is hereby

ORDERED that Receiver's Motion is GRANTED.

BY THE COURT:

S/ James T. Giles

C.J.

copies by FAX on

to