UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

BAY LOAN AND INVESTMENT BANK, Plaintiff	:	
v.	:	C.A. No. 91-240L
CHARLES D. GAUVIN, Defendant.	:	

DECISION AND ORDER

Ronald R. Lagueux, Chief Judge.

This matter is before the Court for decision following a short bench trial. Plaintiff Bay Loan and Investment Bank ("Bay Loan") filed a five count complaint against defendant Charles D. Gauvin ("Gauvin") for his alleged misconduct as an investor with Dean Street Development's ("Dean Street") real estate venture known as the Charlestown Inn Condominium ("CIC"). Count I of the complaint seeks enforcement of promissory notes that Gauvin delivered to Bay Loan. Count II avers a claim of common law fraud. Count III states a cause of action for securities fraud under the Securities Exchange Act of 1934. Count IV proceeds under a theory of bank fraud. Count V states a claim for negligent misrepresentation.

I. Discussion

The underlying facts concerning Dean Street's CIC investment scheme and Gauvin's role within it were elaborately

set forth by the Court of Appeals for the First Circuit in U.S. v. Brandon, 17 F.3d 409 (1st Cir. 1994). In that case, a three judge panel of the First Circuit affirmed Gauvin's six underlying criminal convictions by a jury -- one for conspiracy, and five for bank fraud -- which arose from Gauvin's fraudulent investment activity with Dean Street. In this related civil proceeding, Bay Loan seeks money damages for the same wrongful conduct for which Gauvin has been held criminally liable. In this matter, therefore, Gauvin is estopped from denying the facts that were necessary or essential to his six underlying criminal convictions for firmly established statutory and case law reasons. See Allen v. McCurry, 449 U.S. 90, 94, 101 S. Ct. 411, 415, 66 L.Ed.2d 308 (1980)(collateral estoppel applies when a court decides an issue of fact necessary to its judgment in a prior proceeding); In The Matter of Missionary Baptist Foundation of America, 712 F.2d 206 (5th Cir. 1983)(court may take judicial notice of the record in prior related proceedings); Fed. R. Evid. 201 (judicial notice). See also 18 U.S.C. § 3664(e)(Victim and Witness Recovery Act). This Court, therefore, will rely heavily on the facts set forth in the Brandon decision which relate to the factual issues in this case, since those issues have been already litigated and decided. See State v. Wiggs, 635 A.2d 272 (R.I. 1993)(citing State v. Chase, 588 A.2d 120 (R.I. 1991)). All relevant facts from Brandon, in combination with the trial testimony offered in this case, will be referenced under the foregoing sections of this opinion that correspond to the counts in plaintiff's complaint.

A. Count I: Promissory Note Claim

Plaintiff's first claim seeks recovery for Gauvin's failure to repay his loan in accordance with the agreement contained in the promissory notes that he executed with Bay Loan. The evidence establishes that Gauvin executed four valid promissory notes with Bay Loan. Plaintiff's Exhibit 6 is the loan file that Bay Loan kept to record its business transactions with Gauvin. Within that file is the promissory note that Gauvin signed on August 11, 1987 for Unit #11 in CIC. Plaintiff's Exhibits 7 through 9 are the three additional notes that Gauvin executed on August 11, 1987 with Bay Loan. Each of these notes corresponds respectively to Units #19, #20 and #21 in CIC. Each note was validly executed by Gauvin and is supported by valid consideration.

The evidence at trial also establishes that Gauvin failed to pay Bay Loan in accordance with the four notes. Since Gauvin has failed to honor the terms of the notes, he is liable for the amount due on each note. Therefore, judgment shall enter for plaintiff on Count I.

B. Count II: Common Law Fraud

Plaintiff's second claim proceeds under a theory of common law fraud. Under Rhode Island law, the four elements of that tort are: (1) a false and misleading statement of material fact; (2) known by the defendant to be false; (3) made with intent to deceive; (4) on which the plaintiff relied to his detriment. National Credit Union Admin. Board v. Regine, 795 F. Supp. 59 (D.R.I. 1992). The following facts as stated in the Brandon

On January 1, 1985, . . . Peter Brandon and two others formed a partnership called [Dean Street] for the purpose of buying, developing, and selling real estate. Specifically, Brandon planned to buy and renovate motels along the Rhode Island seashore, convert them into condominiums and then sell the individual rooms to investors as condominium units.

. . . Brandon planned to arrange all the financing for the buyers. He hoped to obtain 100% financing, that is, loans for the complete purchase price of each unit. With such financing, buyers could invest in the project without putting any money down . . .

In early 1987, Brandon approached Homeowner's Funding Corporation ("Homeowners"), a mortgage broker that acts as an intermediary between banks and borrowers, to obtain these "end loans" for the buyers. Homeowners' President told Brandon that 100% financing was unavailable for the project. Rather, the best Brandon could hope to find was 80% financing with a 20% down payment required from the buyers. Homeowners subsequently searched for a lender and, after approaching several banks, located [Bay Loan], a financial institution insured by the Federal Deposit Insurance Corporation. Bay Loan agreed to lend buyers of Dean Street's condominium units up to 80% of the required purchase price.

Homeowners, as well as East - West Financial Corporation ("East West"), the other mortgage broker involved in this case, acted as brokers and servicing agents for Bay Loan. Bay Loan was the actual lender for the Dean Street project and it financed every condominium sale involved in the scheme. By prior agreement, Homeowners and East West provided the original mortgages for the buyers and then sold them to Bay Loan. Homeowners and East West would forward all the loan applications to Bay Loan for approval prior to providing the mortgages for the condominium units. The decision of whether to fund a particular mortgage rested entirely with Bay Loan and Bay Loan set the terms and conditions of each mortgage.

As Bay Loan Vice President of consumer lending, Joseph Gormley, explained to Brandon, the bank required each buyer of a condominium unit to make at least a 20% down

payment to the seller, Dean Street, before Bay Loan could fund the loans. Instead of instructing buyers to provide the required down payments, however, Brandon concocted a scheme that permitted buyers to avoid the down payments altogether. As a result, he was able to pursue his original goal of obtaining 100% financing for the condominium project. . . .

Brandon planned and employed three basic methods of falsifying the down payments. The first method was simply providing money to the various buyers which the buyers would then use to make the down payments to Dean Street. Usually the money came from third-party investors to whom Brandon promised a commission for each down payment they funded. Once the buyer made the down payment to Dean Street, Dean Street would return the money to the investor leaving a paper trail for a down payment that was never actually made. The second method involved obtaining down payment checks from the buyers and promising not to cash them. Copies of these nonnegotiated checks would remain in the loan file to give the appearance that real funds had actually been transferred. The third method was to provide second mortgages to the buyers to fund their down payments and then to discharge those mortgages after the closings.

The first method of avoiding down payments was employed from the outset of the scheme. [Gauvin and Marvin Granoff ("Granoff")] agreed with Brandon to purchase some units at [CIC]. Gauvin and Granoff also agreed to provide down payment funds to other buyers for subsequent unit sales. Brandon promised them $1,000 for each unit sold with their down payment funds. In August of 1987, Gauvin, Granoff and a third person each purchased four units. . . . During the closing, [Brandon's attorney] recorded the amount of each down payment ($20,500) on the closing statements -- also called the HUD settlement sheets -- as 'amounts paid by or in behalf of borrower.'

Gauvin provided the down payment funds for these twelve purchases but no actual payment was ever made; instead, the funds were passed through Dean Street and returned to Gauvin. At the closing, Gauvin delivered twelve separate checks for $20,500 each to [Brandon's attorney], drawn on an account

> that only had a $6,000 balance at the time, and [another attorney acting as an escrow agent] deposited the checks in his escrow account. [The escrow agent] then wrote twelve corresponding checks to [Brandon's attorney] who in turn wrote checks to Dean Street for identical amounts of $20,500 each. Two days later, Dean Street wrote twelve checks back to Gauvin for the same amounts of $20,500 each, and Gauvin deposited the money in the original checking account to cover his initial twelve checks written as down payments to the seller.
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> In late August and September of 1987, Gauvin provided down payments for the purchase of units at [CIC] and at the Bayside Motel by [others]. As with the first purchases, Dean Street returned the down payment money within a matter of days and also paid Gauvin the additional $1,000 per unit.
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> In the beginning of 1988, Bay Loan began requiring that down payments be made with certified funds. Gauvin and Granoff agreed to provide buyers with funds so that they could obtain certified checks before closings. [Dean Street was to return the money to Gauvin and Granoff after the closing. At some point, Granoff and Gauvin ceased to give Dean Street money for others' down payments.]
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> . . . Gormley at Bay Loan, who approved the loans, did not know that down payment funds came from sources other than the buyers, that some down payments were nonnegotiated checks, that second mortgages were being discharged, or that buyers were being paid to purchase units. Gormley testified that he would not have approved the loans if he had been aware of any of these circumstances...

Brandon, 17 F.3d at 417 - 21. The facts established in the Brandon case clearly satisfy plaintiff's burden of proof as to its claim of common law fraud.[1] It is clear that Gauvin made a

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[1]The facts cited in support of this point are essential to Gauvin's underlying convictions for conspiracy as well as for five counts of bank fraud.

series of false and misleading statements to Bay Loan regarding the down payments made on each of the CIC units that he purchased. All of those misrepresentations were material to Bay Loan's decision to extend the loans. Gauvin knew his statements to be false, and he intended to make them to deceive the bank. His goal was clearly to finance his investment in CIC with no down payment.

The Brandon case also reveals the direct and reasonable reliance by Bay Loan upon Gauvin's misrepresentations. It is clear that although Homeowners and East West were providers of the mortgages to the purchasers of individual units in CIC, it was actually Bay Loan that was responsible for approving Gauvin's loans. Any representations that were made by Gauvin were communicated directly to Bay Loan, who relied on them in deciding to approve his loan applications. Furthermore, Bay Loan's reliance on the disclosures made by Gauvin regarding the financing of the units that he purchased was eminently reasonable. It was only the cooperative, clandestine misconduct of Gauvin, Dean Street, and the individual unit purchasers that allowed the misrepresentations regarding the down payments to remain undiscovered.

Defendant's argument at trial -- that Bay Loan's reliance could not have been reasonable because another entity issued the original mortgage -- cannot carry the day. It is clear from Brandon that Bay Loan was actually making the decisions about whether the loans should issue. The role of the mortgage brokers (Homeowners and East West) was merely to set up the transactions

and to issue the mortgages. It had already been agreed upon in advance that Bay Loan would purchase the mortgages from the brokers after the mortgages were issued. Therefore, it was Bay Loan who relied on the information contained in the mortgage applications to its detriment.

Plaintiff has proved all the elements of common law fraud. Therefore, judgment shall enter for plaintiff as to Count II.

C. Count III: Securities Fraud

Count III of plaintiff's complaint states a cause of action for violation of the federal securities laws. Specifically, plaintiff invokes Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated by the SEC to seek redress for the misrepresentations made by Gauvin in his loan transactions with Bay Loan. Section 10 of the 1934 Act reads in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of a national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 of the Rules and Regulations Under Securities Exchange Act of 1934, 17 C.F.R. §240 (1934), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit on any person, in connection with the purchase or sale of any security.

The same facts upon which plaintiff relied to prove common law fraud are also dispositive of plaintiff's securities fraud claim. The evidence establishes that Gauvin made misrepresentations to Bay Loan as part of his mortgage application, that he knew those statements were false, and that those statements caused the bank injury because the bank reasonably relied on them. There are, however, two additional elements which the plaintiff needs to prove to recover for Gauvin's misrepresentations under the federal securities laws.

The first element is that the buyers' investments in the individual condominium units in CIC were investments in <u>securities</u> or <u>investment contracts</u> under the 1934 Act. In <u>SEC v. W. J. Howey Co.</u>, 328 U.S. 293, 298 - 99, 66 S. Ct. 1100, 1103, 90 L.Ed. 1244 (1946), the Supreme Court held that

> "an investment contract for purposes of the Securities Act [of 1933] means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the in the enterprise are evidenced by formal certificates or by nominal interests in the

> physical assets employed by the enterprise. . . . [This definition] embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."

See Williamson v. Tucker, 632 F.2d 579 (5th Cir. 1980) (applying the same definition to the Securities Exchange Act of 1934). Thus, the test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America v. Daniel, 439 U.S. 551, 99 S. Ct. 790, 58 L.Ed.2d 808 (1979)(applying the Securities Exchange Act of 1934).

In this case, the master lease executed between Dean Street and the individual purchasers of the condominium units (including Gauvin) required that the purchasers lease their units back to Dean Street after purchase. The master lease set forth the following plan:

> [T]he condominium buyers would lease the units back to Dean Street and Dean Street would then manage the properties as motels. Under the "lease-back" agreement with the buyers, Dean Street would apply the income from the operation of the motels to cover the monthly mortgage, tax and insurance costs incurred by the unit buyers. Any shortfalls in operating costs would be made up by Dean Street, leaving the buyers with no monthly costs on their investment.
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> In addition, buyers would be allowed to use their units for two weeks out of the year. Dean Street would also guaranty them a certain level of profit at sale. Some buyers would receive rebates for each unit they purchased. . . .

Brandon, 17 F.3d at 417. Thus, the buyers of the units were to relinquish control of the units to Dean Street, and Dean Street was to manage the units on behalf of the buyers and to try to turn a profit. The buyers' interests in the condominium units in CIC were, therefore, investment contracts or securities, since the buyers relinquished control over their investment. The Securities Exchange Act of 1934, see 15 U.S.C. § 78c(a)(10), is, therefore, applicable.

The second element that must be proven to hold Gauvin liable under the federal securities laws is that the mortgage transaction between himself and Bay Loan constituted a sale of securities, covered by the 1934 Act. Bay Loan contends that the mortgage or pledge of the units, as collateral for the loans, constituted a sale for purposes of the securities laws. This Court agrees. In Rubin v. United States, 449 U.S. 424, 101 S. Ct. 698, 66 L.Ed.2d 633 (1980), the Supreme Court held that, for purposes of the Securities Act of 1933, the term "sale" shall include every contract of sale or disposition of a security or interest in a security for value. The Court also noted that "[a]lthough pledges transfer less than absolute title, the interest thus transferred nonetheless is an 'interest' in a security." 449 U.S. at 429, 101 S. Ct. at 701. Later, the Court made it clear that pledges were sales for purposes of all federal securities laws. Marine Bank v. Weaver, 455 U.S. 551, 554 n.2, 102 S. Ct. 1220, 1222 n.2, 71 L.Ed.2d 409 (1981)(holding

that pledges amount to sales under the 1934 Act). In this case, it is clear that the buyers' interests in the units in the CIC were pledged to Bay Loan as collateral to secure the notes. Without those pledges, Bay Loan would not have made the mortgage loans. Therefore, a sale took place for purposes of the federal securities laws, as an interest in a security was transferred.

Plaintiff has met its burden with respect to its claims for securities fraud. Therefore, judgment shall enter for plaintiff on Count III.

D. Count IV: Bank Fraud

Count IV in plaintiff's complaint makes out a claim for bank fraud. Plaintiff seeks to invoke 18 U.S.C. § 1343 to recover damages. Plaintiff offers the same evidence already referenced to support its claim.

Plaintiff, however, has made a fundamental mistake. The statute relied on as the basis for this cause of action is 18 U.S.C. § 1343. That is a criminal statute. It does not operate to create a federal civil cause of action for damages against those who have violated its provisions. Napper v. Anderson, Henley, Sheilds, Bradford and Pritchard, 500 F.2d 634, reh'g denied, 507 F.2d 723, cert. denied, 423 U.S. 837, 96 S. Ct. 65, 46 L.Ed.2d 56 (1974). As a result, judgment on Count IV shall enter for defendant.

E. Count V: Negligent Misrepresentation

Count V of plaintiff's complaint proceeds under a theory of negligent misrepresentation. Rhode Island law recognizes the tort of negligent misrepresentation, see Estate of Braswell v.

Braswell, 602 A.2d 510 (R.I. 1992), and looks to the Restatement (Second) of Torts for guidance in interpreting its principles. See Forcier v. Cardello, 173 B.R. 973 (D.R.I. 1994); Rusch Factors v. Levin, 284 F. Supp. 85 (D.R.I. 1968). Section 552 of the Restatement (Second) of Torts, which sets forth the tort of negligent misrepresentation, states:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
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> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
>
> (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

The evidence shows that Gauvin, at the very least, negligently misrepresented the fact that he did not make a down payment on the units in the CIC. The evidence also proves that Gauvin's misrepresentation was intended to mislead Bay Loan about the actual purchase price for the units, the value of the units, and

Bay Loan's own interest in the units. It is also clear that it was foreseeable that Bay Loan would rely on these misrepresentations, and that it was Gauvin's secretive activities that prevented the bank from recognizing the fraud. It is also clear that the misrepresentations were the cause of the injury, as Bay Loan would not have made the loans if Gauvin had represented the truth on his lending forms.

Therefore, plaintiff has met its burden with regard to Count V. Judgment shall enter for plaintiff on Count V.

F. Damages

The damages suffered by the plaintiff in this case are readily ascertainable, and are identical under each count of the complaint. Gauvin must compensate Bay Loan for the amount outstanding on the promissory notes, plus interest, and for any real estate taxes and insurance costs disbursed by plaintiff in connection with Gauvin's investment in CIC.

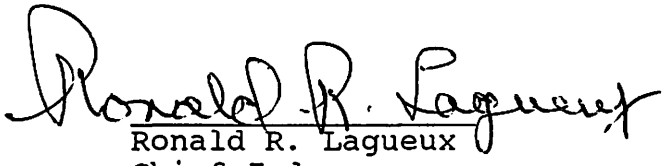
Plaintiff's Exhibit 10 is a summary sheet which sets forth the amounts owing by Gauvin to Bay Loan. Gauvin executed a promissory note for each of the four units in CIC that he bought (#11, #19, #20, #21). The outstanding principal on each of those notes is $60,112.04. Thus, the total outstanding principal owed by Gauvin to Bay Loan is $240,448.16. The interest on that principal has been delinquent since January 15, 1989. The interest rate set forth in the promissory notes is 12.5% per annum. In addition to the principal and the accrued interest, plaintiff has also proved that it made payments of $8,000 for real estate taxes and $277.80 for insurance premiums on behalf of

Gauvin.

II. Conclusion

On Counts I, II, III, and V, judgment shall enter for plaintiff in the amount of $240,448.16 plus interest calculated at the rate of 12.5% per annum from January 15, 1989 to this date, plus $8,277.80 for tax and insurance disbursements made by plaintiff. On Count IV, judgment shall enter for defendant. The Clerk will enter judgments forthwith.

It is so ordered.



Ronald R. Lagueux
Chief Judge
July 25, 1995