

**UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
CIVIL MINUTES - GENERAL**

Case No. SA CV 01-701 DOC (MLGx)
Case No. SA CV 01-702 DOC (MLGx)
Case No. SA CV 01-704 DOC (MLGx)
Case No. SA CV 01-706 DOC (MLGx)
Case No. SA CV 01-707 DOC (MLGx)
Case No. SA CV 01-708 DOC (MLGx)
Case No. SA CV 01-709 DOC (MLGx)

Date: November 16, 2001

Title: Robb Evans, as Receiver for TLC Investments, et al. v. Jeffrey Nickel, et al.

DOCKET ENTRY

[I hereby certify that this document was served by first class mail or a Government messenger service, postage prepaid, to all counsel (or parties) at their respective most recent address of record in this action on this date.]

Date: _____ **Deputy Clerk:** _____

PRESENT:

THE HONORABLE DAVID O. CARTER, JUDGE

Kristee Hopkins
Courtroom Clerk

Not Present
Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFFS
NONE PRESENT

ATTORNEYS PRESENT FOR DEFENDANTS:
NONE PRESENT

PROCEEDING (IN CHAMBERS): DENYING DEFENDANTS' MOTION TO DISMISS

Before the Court are motions to dismiss filed by various defendants in seven related cases. In each case, the underlying facts of the complaints are substantially the same. The moving Defendants are all represented by one of two counsel, and present identical motions in each case. Plaintiff's oppositions are all substantially identical. Accordingly, the Court decides the motions together. The Court deems this matter appropriate for decision without oral argument. Fed. R. Civ. P. 78; Local Rule 7-15. After consideration of the moving, opposing, and replying papers, and for the reasons set forth below, the Court **DENIES** the Motion.

I. BACKGROUND

On November 1, 2000, this Court appointed Plaintiff Robb Evans as the Permanent Receiver for TLC Investments & Trade Co.; TLC America, Inc. d.b.a. Brea Development Co.; TLC Brokerage, Inc. d.b.a. TLC Marketing; TLC Development, Inc.; TLC Real Properties RLLP-1; Cloud & Associates Consulting, Inc. (collectively TLC) in the underlying action brought by the Securities and Exchange Commission. *SEC v. TLC*, SA CV 00-960 DOC (EEEx).

TLC purported to be in the business of buying distressed real estate, such as foreclosed properties, for resale at a profit. TLC issued two types of securities: promissory notes and one- or two-year, renewable investment agreements sold through TLC Brokerage's 130 agents nationwide. From 1996 to the present, at least 2,627 investors, the majority of whom are senior citizens, purchased TLC investments. TLC raised over \$156 million from these investors.

The SEC alleged that TLC engaged in several kinds of securities fraud relating to their purported real estate business. Paramount among the SEC's allegations was that TLC had engaged in a Ponzi scheme. According to the SEC, TLC falsely represented that it was engaged in the real estate business when it was in fact using investor funds to: (1) pay other investors; (2) invest \$20 million in a fraudulent prime bank scheme; (3) buy racehorses; (4) make charitable contributions in the amount of \$1.55 million to the high school football team that TLC's president's son played for, including \$1 million for repairs to the stadium; and (5) be wired overseas even though TLC securities' issuing documents said TLC never invested overseas. The SEC has obtained judgments against all of the original defendants in that action, including TLC, its president, its chief financial officer, and one of its major outside brokers.

Plaintiff commenced these related actions against TLC brokers and agents for disgorgement of commissions paid to them for selling TLC investments. Plaintiff brings these actions pursuant to his authority as the Equity Receiver to "institute, pursue, and prosecute all claims and causes of action of whatever kind and nature which may now or hereafter exist as a result of the activities of present or past employees or agents of TLC" *SEC v. TLC*, SA CV 00-960 DOC (EEx) (C.D. Cal. Nov. 1, 2000), Order of Prelim. Inj. at 10. Plaintiff was specifically authorized and ordered by this Court to seek recovery of commissions paid to agents to return to investors of TLC. *SEC v. TLC*, SA CV 00-960 DOC (EEx) (C.D. Cal. March 8, 2001) Order on Receiver's Quarterly Report as of December 31, 2000 at 2.

Plaintiff brings these claims under the California version of the Uniform Fraudulent Transfers Act (UFTA), Cal. Civ. Code §§ 3439.04-.05. Plaintiff alleges three causes of action: (1) transfer with the intent to defraud creditors, Cal. Civ. Code §3439.04(a) (transfer with actual fraud); (2) transfer without receiving reasonably equivalent value and the debtor's assets were unreasonably small or had the debtor would not have the ability to pay his debts, Cal. Civ. Code § 3439.04(b) (transfer with constructive fraud); and (3) transfer without receiving reasonably equivalent value and the debtor is insolvent, Cal. Civ. Code § 3439.05 (transfer with constructive fraud). Defendants now move to dismiss the complaints for three reasons: (1) Plaintiff lacks standing as an Equity Receiver to bring suit under the UFTA; (2) Plaintiff has not pled fraud with particularity as required under the Federal Rules of Civil Procedure; and (3) Plaintiff's claims for constructive fraudulent transfers under the UFTA are legally insufficient.

II. STANDING

Defendants argue that the receiver does not have standing to assert a claim under the UFTA. The UFTA gives a right to a creditor to void a fraudulent conveyance. Cal. Civ. Code § 3439.07(a). Defendants contend that the receiver is not a creditor of TLC, but instead stands in the place of TLC. Under Defendants' analysis, only the individual investors who have been defrauded¹ may bring an action under the UFTA.

The UFTA defines a "creditor" as "a person who has a claim . . ." Cal Civ. Code § 3439.01(c). A "claim" is defined as "a right of payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." Cal Civ. Code § 3439.01(b). This definition of claims and creditors is nearly identical to that contained in the bankruptcy code. 11 U.S.C. §§ 101(5)(A), 101(10). A receiver is treated much like a bankruptcy trustee. *See* Local Rule 66-8. Cases analyzing a receiver's standing under the UFTA and similar laws have analogized to a bankruptcy trustee's authority to do the same. *See Scholes v. Lehman*, 56 F.3d 750, 753 (7th Cir. 1995); *see also Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1515 (1st Cir. 1987).

In *Scholes*, the Seventh Circuit held that a receiver had standing to bring suit under the Illinois predecessor to the UFTA on behalf of investors that had been defrauded by an illegal Ponzi scheme. *Scholes*, 56 F.3d at 753. Writing for the panel, Chief Judge Posner rejected the transferees' arguments that the receiver was limited only to those causes of action that the corporation in receivership could bring. *Id.* While a receiver can sue only to redress the injuries to the entity in receivership, Judge Posner noted that "[t]he appointment of the receiver removed the wrongdoer from the scene. The corporations were no more [the owner's] evil zombies. Freed from his spell they became entitled to the return of the moneys-for the benefit not of [the owner] but of innocent investors . . ." *Id.* at 754.

Scholes would appear to be on all fours with the instant case. This Court is not the only one to think so. In a similar case, Judge Morrow of this district ruled that a receiver of a corporation involved in a telemarketing scheme could bring suit under the UFTA. *Moldo v. World Net Dev. Group, Inc.*, No. CV 9807475 MMM (MCx), 2000 U.S. Dist. Lexis 19092 (C.D. Cal. Sept. 20, 2000).² A Texas district court similarly held that a receiver of a corporation

involved in a ponzi scheme had standing to bring suit under the Texas version of the UFTA. *SEC v. Benjamin Franklin Cook*, No. CV272-R, 2001 U.S. Dist. LEXIS 2601.

Defendants argue that the Supreme Court's decision in *Caplin v. Marine Midland Grace Trust Co. of New York*, 406 U.S. 416, 92 S. Ct. 1678 (1971), stands for the opposite proposition. In *Caplin*, a trustee appointed under the former Bankruptcy Act brought a suit on behalf of certain bondholders against the debtor's indenture trustee to recover for the indenture trustee's bad faith failure to require the debtor to comply with the terms of the indenture. In a 5-4 decision, the Supreme Court held that the trustee could not bring the actions that benefitted only the individual bondholders, and not the estate, or its creditors, as a whole. *Id.* at 429, 92 S. Ct. at 1685. However in this case, like in *Moldo*, the receiver is bringing a claim for monies that "can be characterized both as the recovery of assets belonging to the Receivership Entities, and as the recovery of assets for the benefit of creditors of those assets." *Moldo*, 2000 U.S. Dist. Lexis 19092, at *24. Although a receiver or trustee cannot bring claims to benefit a limited number of investors, it can bring suits that serve to benefit all the creditors of an estate. *Id.*

Caplin is also inapplicable because it relies on Justice Cardozo's decision in *McCandless v. Furlaud*, 296 U.S. 140, 56 S. Ct. 41 (1935) that a receiver can only bring a claim that a corporation would otherwise be able to bring. TLC would be able to bring this action itself, now that it has been, in the words of Judge Posner "freed from [the] spell" of the wrongdoing owner. *Scholes*, 56 F.3d at 754.

Finally, then-Judge Breyer's opinion in *Boston Trading Group*, 835 F.2d at 1516, is inapplicable. The First Circuit held that the receiver in that case could not bring a claim under the Massachusetts Fraudulent Conveyance Act because the order appointing the receiver did not include that authority. The First Circuit stated "[p]erhaps, if the Receiver had requested authorization to bring such a suit, the district court would have granted it." *Id.* Here, such authority has been granted, if not by the original appointment, then undoubtedly by the March 8, 2001 order approving the receiver's quarterly report, which stated "[t]he Court finds that commissions, bonuses, or other expenses paid to agents are recoverable assets of the Receivership Estate and authorizes and instructs the Receiver to pursue repayment." *SEC v. TLC*, SA CV 00-960 DOC (EEx) (C.D. Cal. March 8, 2001) Order on Receiver's Quarterly Report as of December 31, 2000 at 2.

III. PLEADING FRAUD WITH PARTICULARITY

Defendants next argue that Plaintiff's First Claim for Relief should be dismissed because it fails to plead fraud with particularity. Fed. R. Civ. P. 9(b). At the outset, it is important to note that even though the complaint is to void a fraudulent transfer, it is not a complaint for fraud. To make a claim under the UFTA, a plaintiff must prove standing as a creditor, a transfer to hinder, delay or defraud collection, and insolvency. See *Carter-Jones Lumber Co. v. Denune*, 725 N.E.2d 330, 333 (Ohio Ct. App 1999) (construing the Ohio version of the UFTA). Such a claim has very little in common with a claim for fraud, where a plaintiff must show a material false representation, scienter, intent, reliance, and damages. *Id.* The argument that a fraudulent transfer claim must be plead with particularity

confuses the *issue* of a fraudulent conveyance with a *claim* of common-law fraud. Complaints alleging fraud must be pleaded with particularity. However, a conveyance may be fraudulent as to creditors under [the UFTA] if it renders the debtors insolvent without regard to his actual intent, and even if there is no evidence of misrepresentation by the debtor.

Id. (applying Ohio Civil Rule 9(b), parallel to Federal Rule of Civil Procedure 9(b), to the UFTA). Accordingly, the heightened pleading requirements do not generally apply to a claim for a fraudulent transfer or conveyance. *Id.*

Plaintiff's concede that there is a heightened pleading requirement for a claim under Cal. Civ. Code § 3439.04(a), a transfer with actual fraud. The Court, however, is not convinced of this. *But see Van-American Ins. Co. v. Schiappa*, 191 F.R.D. 537, 543 (S.D. Ohio 2000); *Nisselson v. Drew Indus. Inc. (In re White Metal Rolling and Stamping Corp.)*, 222 B.R. 417, 428 (Bankr. S.D.N.Y. 1998). The statute does not require that the transferor have made an actual misrepresentation, but merely that the transferor intends to wrongly deny the creditor money or property due to it. Indeed, the only requirement related to fraud, even under the so-called actual fraud provisions, is the transferor's (here, TLC) intent to defraud. Intent, however, may be "averred generally." Fed. R. Civ. P. 9(b).

Nevertheless, Plaintiff has met the heightened requirements under 9(b). In general, fraud claims must be pled with more particularity than other claims. Federal Rule of Civil Procedure 9(b) provides that, "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." "Rule 9(b) ensures that allegations of fraud are specific enough to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Semegen v. Weidner*, 780 F.2d 727, 731 (9th Cir. 1985). "The purpose of Rule 9(b) is to prevent the filing of a complaint as a pretext for the discovery of unknown wrongs." *In re Silicon Graphics, Inc. Secs. Litig.*, 970 F. Supp. 746, 752 (N.D. Cal. 1997) (citing *Semegen*, 780 F.2d at 731). In other words, Rule 9(b) is meant to prevent "fishing expeditions." The requirements are somewhat relaxed when the circumstances of the alleged fraud are "peculiarly within the opposing party's knowledge." *Glen Holly Entm't, Inc. v. Tektronix, Inc.*, 100 F. Supp. 2d 1086, 1095 (C.D. Cal. 1999).

Here, Plaintiff is not undertaking a "fishing expedition." Nor is the complaint made as a pretext for discovery of unknown wrongs, as the fraudulent acts alleged are solely those of TLC and the other defendants in the underlying case. The only wrong that the Defendants are alleged to have committed is their knowledge of the fraud, an affirmative defense. Cal Civ. Code § 3439.08(a). "[K]nowledge . . . may be averred generally." Fed R. Civ. P. 9(b). The fact that the fraudulent acts are those stemming from the underlying case is clear from the complaint, and, as Plaintiff points out, are available to Defendants.³

IV. CONSTRUCTIVE FRAUD CLAIMS

Defendants finally argue that Plaintiff's constructive fraud claims must fail as a matter of law. Defendants point out that under California law, the contracts of a debtor are valid against creditors in the absence of fraud. Cal. Civ. Code §3431. Defendants therefore argue that their agent agreements with TLC are valid unless actual fraud can be proven.

This argument would effectively abolish the UFTA. The purpose of the UFTA's constructive fraud provisions is to allow a creditor to void a transfer by an insolvent creditor that is made for less than fair value, including one made by contract. If section 3431 made it impossible to void any contract absent actual fraud, then a debtor could never make use of the UFTA's constructive fraud provisions. The UFTA is therefore an alteration to the general rule, enacted in 1872.

V. CONCLUSION

Accordingly, Defendants' motions to dismiss are **DENIED**.

The Clerk shall serve this minute order on all parties to the actions.⁴

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(Initials of Deputy Clerk _____)

¹ Or potentially the SEC which has obtained a judgment against TLC.

² The Court notes that a number of the counsel involved in that case are involved in this matter.

³ If there were any question as to whether the complaint pled fraud with sufficient particularity, Plaintiff could simply reference or attach the complaint by the SEC in the underlying action.

⁴ A copy of this order shall be filed in all case numbers.