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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

D. RAY STRONG, as Liquidating Trustee of the Consolidated Legacy Debtors Liquidating Trust, the Castle Arch Opportunity Partners I, LLC Liquidating Trust and the Castle Arch Opportunity Partners II, LLC Liquidating Trust, Plaintiff, v. KIRBY D. COCHRAN; JEFF AUSTIN; AUSTIN CAPITAL SOLUTIONS; WILLIAM H. DAVIDSON; DOUGLAS W. CHILD; CHILD, VAN WAGONER & ASSOCIATES, PLLC, fka CHILD, SULLIVAN & ASSOCIATES, fka CHILD, VAN WAGONER & ASSOCIATES, LLC, fka CHILD VAN WAGONER & BRADSHAW, PLLC; ROBERT CLAWSON; HYBRID ADVISOR CROUP; and JOHN DOES 1-50, Defendants.	**RESPONSE TO MOTION OF DEFENDANTS JEFF AUSTIN AND AUSTIN CAPITAL SOLUTIONS TO COMPEL ARBITRATION AND/OR DISMISS** Case No. 2:14-cv-00788-TC Judge Tena Campbell

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Plaintiff D. Ray Strong, in his capacity as Liquidating Trustee (the "Trustee") of the Consolidated Legacy Debtors Liquidating Trust, the Castle Arch Opportunity Partners I, LLC Liquidating Trust and the Castle Arch Opportunity Partners II, LLC Liquidating Trust (collectively, the "Trusts"), hereby files this Response to the *Motion of Defendants Jeff Austin and Austin Capital Solutions to Compel Arbitration Pursuant to 9 U.S.C. § 4 & Utah Code § 78B-11-108; Stay the Case Pursuant to 9 U.S.C. § 3 & Utah Code § 78B-11-108; and/or Dismiss the Claims Pursuant to Federal Rule of Civil Procedure 12(b)(6)* (the "Motion").

INTRODUCTION

Defendant Jeff Austin ("Austin") was originally the Senior Vice President of Business Development and a member of Castle Arch Real Estate Investment Company's ("CAREIC") Board of Directors and, in November 2010, was named its CEO. Complaint, ¶ 23. CAREIC and its affiliated entities (collectively, the "Debtors") were real estate investment companies that raised over $73 million from investors to purportedly acquire, entitle, and develop real property. *Id.* at ¶ 2. But by the time the Debtors eventually filed for bankruptcy in October 2011, under the direction of their management, including Austin, they had failed to successfully entitle, develop, or sell all but one small parcel of real property that they had acquired and never generated more than nominal revenue to repay investors. *Id.* at ¶¶ 5-6. Despite the Debtors' lack of success in their core objectives and their inability to repay investors, Austin, along with the other officers and directors of the Debtors used over 25% of the funds raised for executive compensation and fundraising expenses, such as finders' fees and commissions. *Id.* at ¶ 14.g.

As President of Worldwide Business Development,[1] Austin was the individual at CAREIC who was principally responsible for managing the Debtors' capital-raising activities, including preparing and disseminating the company's investment documents. *Id.* at ¶ 174. In this role, Austin solicited investors in the Debtors' securities and supervised other CAREIC employees in making such sales. *Id.* at ¶ 175. Though he was President of Worldwide Business Development, and responsible for capital-raising, Austin was never registered as a broker-dealer. *Id.* at ¶ 177. Nor were most of CAREIC's other employees who were soliciting investors day to day. *Id.* at ¶ 175. Austin also supervised the preparation and dissemination of the Debtors' private placement memoranda ("PPMs") that contained numerous omissions and material misstatements. *See id.* at ¶¶ 198-243.

CAREIC's management, including Austin continued the Debtors' improper practices of overpaying management, permitting management to spend insufficient time on the business, allowing sales of securities by unlicensed broker-dealers, and other negligent and improper behavior after Austin took over as CAREIC's CEO in November 2010. *Id.* at ¶¶ 134-86. As CAREIC's CEO, Austin furthered these practices. Additionally, as CEO, Austin failed to make a claim on, removed the Debtors as insureds under, and reduced coverage by $4 million on the Debtors' insurance policy provided through Axis Surplus Insurance Company (the "Axis Policy"). *Id.* at ¶¶ 187-97. This failure has subjected the Debtors to an additional $4 million in liability.

The Trustee filed his Complaint against Austin and his company, Austin Capital

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[1] Although the Complaint alleges Austin was "Senior Vice President," the CAREIC PPM attached to the Declaration of Jeff Austin in Support of the Motion [Docket No. 13] as Exhibit 1 in fact identifies him as "President of Worldwide Business Development." CAREIC PPM, at 25 & 26.

Solutions ("Austin Capital"), and other CAREIC officers and directors and their associated entities seeking to recover fraudulent and preferential transfers made to them and to recover for their myriad breaches of fiduciary duties and their fraudulent behavior relating to the sale of the Debtors' securities.

Austin, however, seeks to evade all liability for his misdeeds by claiming that, despite his role as President of Worldwide Business Development, his supervision of all of the Debtors' fundraising, and his eventual position as CEO, *he owed no fiduciary duties to the Debtors* and could not be liable for any of the Debtors' fraudulent dealings relating the sales of their securities. Austin also believes that he should not be required to return over $1 million in transfers made to him by CAREIC despite the fact that those transfers were egregiously high considering Austin's qualifications. At the same time, Austin claims that he is entitled to an alleged additional over $1 million in unpaid salaries and bonuses from CAREIC. Austin asks the Court to relieve him of any liability at the pleading stage, on a motion to dismiss. In considering such a motion, the Court must take the well-pled allegations of the Complaint as true, and must consider them in the light most favorable to the non-moving party. Austin's motion should be denied because it has no legitimate legal basis.

FACTUAL BACKGROUND

A. CAREIC and its Affiliated Entitles.

The Debtors operated real estate investment companies and were in the business of developing and entitling raw land. Austin, along with defendants Kirby Cochran ("Cochran") and Douglas Child ("Child"), and one other party formed CAREIC in April 2004. *Id.* at ¶ 32. During CAREIC's existence, CAREIC also formed numerous other entities. *Id.* at ¶ 33.

Relevant to the complaint are two other entities—Castle Arch Smyrna, LLC ("CAS") and Castle Arch Secured Development Fund, LLC ("CASDF").

In February 2007, CAREIC executed an amended operating agreement (the "CAREIC Operating Agreement")[2] listing among others, the Individual Defendants and as Members and stating that the CEO shall manage the company. The CAREIC Operating Agreement permits the CEO to delegate management duties to one or more of CAREIC's officers and also permits the CEO to delegate authority to officers to bind the company. CAREIC Operating Agreement, §§ 3.5 & 3.16. In particular, Section 3.16 of the CAREIC Operating Agreement permits the CEO to delegate the management of CAREIC to one or more officers.

The final paragraph of the CAREIC Operating Agreement—section 15.16—contains a provision titled "Disputes." That section states:

> Any dispute or other disagreement arising from or out of this Amended Operating Agreement of the performance of any office, director or agent on behalf of the Company shall be submitted to arbitration under the rules of the American Arbitration Association. Such arbitration shall be brought in the following venues: Los Angeles County, California, or Salt Lake County Utah.

(the "Arbitration Clause").

On or about June 21, 2007, CAREIC executed an operating agreement for CAS (the "CAS Operating Agreement").[3] CAREIC is listed as the sole Manager and Member of CAS. On or about January 31, 2008, CAREIC executed an operating agreement for CASDF (the

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[2] A copy of the CAREIC Operating Agreement is attached as Exhibit A to the CAREIC PPM, which is attached as Exhibit 1 to the *Declaration of Jeff Austin*, Docket No. 13-1.

[3] A copy of the CAS Operating Agreement is attached as Exhibit A to the CAS PPM, which is attached as Exhibit 2 to the *Declaration of Jeff Austin*, Docket No. 13-2.

"CASDF Operating Agreement").[4] CAREIC is listed as the sole Manager and Member of CASDF. *See* CAS and CASDF Operating Agreements, § 3.2. Neither the CAS Operating Agreement nor the CASDF Operating Agreement contain an arbitration provision.

The Debtors raised funds by soliciting investments in their securities. To do so, they issued numerous private placement memoranda ("PPM"). Specifically, CAREIC issued the following three PPMs that are relevant to the Complaint:

- CAREIC Series E PPM (the "CAREIC PPM"), issued on June 1, 2008, Complaint, ¶ 200;
- CAS PPM, issued on June 25, 2007, *Id.* at ¶ 202; and
- CASDF PPM, issued February 1, 2008. *Id.*

The Complaint alleges that the PPMs contained numerous omissions and material misstatements regarding, among other things, CAREIC management's expertise, the use of the investment proceeds and misfeasance relating to the Company's acquisition and development of real properties. *Id.* at ¶¶ 39-133.

The Debtors raised over $73 million from investors from May 2004 until they filed for bankruptcy in October 2011. But instead of generating revenues and paying investors, the Debtors used approximately 25% of the funds raised to pay executive compensation and related expenses such as finders' fees and commissions. *Id.* at ¶ 14.g. The Debtors employed and contracted with numerous individuals to solicit investors and sales of the securities. Many of these individuals were not licensed with the SEC as broker-dealers. Nevertheless, they were paid handsomely for their work in selling the Debtors' securities. *Id.* at ¶¶ 174-86.

[4] A copy of the CASDF Operating Agreement is attached as Exhibit A to the CASDF PPM, which is attached to the *Declaration of Jeff Austin*, Docket No. 13-3.

CAREIC filed a petition seeking relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq*. in the United States Bankruptcy Court for the District of Utah (the "Bankruptcy Court") on October 17, 2011.[5] *Id.* at ¶ 2. Under the Confirmed Plan, the Trustee may now bring all of the Debtors' claims and causes of action and all of the Debtors' investors' individual claims that were assigned to the relevant trusts in the Confirmed Plan. *Id.* at ¶ 16.

B. Austin's Involvement with CAREIC and its Affiliates.

Austin served as CAREIC's Senior Vice President of Business Development, was a member of CAREIC's Board of Directors, and served as CAREIC's CEO from November 2010 until the appointment of a Receiver in July 2011. *Id.* at ¶ 23. In this capacity, Austin was responsible for managing CAREIC's capital-raising activities, including selling securities to the public through unlicensed broker-dealers by means of material misstatements and omissions. *Id.* at ¶¶ 173-77. Despite this role, Austin was not registered with the SEC as a broker-dealer or associated with a registered broker-dealer. *Id.* at ¶¶ 23 & 177.

C. The Transfers to Austin and Austin Capital and Austin's Proofs of Claims.

Austin was paid handsomely for his work with CAREIC. At one point, Austin had a consulting agreement with CAREIC by which he was to earn a $15,000.00 per month base consulting fee with the opportunity for more payments. This was in addition to a $2,000.00 per

[5] On October 20, 2011, Debtors CAOP Managers, LLC, Castle Arch Kingman, LLC, Castle Arch Secured Development Fund, LLC, Castle Arch Smyrna, LLC, Castle Arch Opportunity Partners I, LLC, and Castle Arch Opportunity Partners II, LLC also filed petitions seeking relief under Chapter 11 of the Bankruptcy Code. Complaint, at ¶ 2. These cases were substantively consolidated and are now being jointly administered. *Id.*

month office-expense allowance. *See* Austin Consulting Agreement.[6] According to the Trustee's books and records, Austin was paid a total of $1,135,089.97 from CAREIC and its affiliates (the "Austin Transfers"). *See* Complaint at Exhibit 3. In addition, Austin Capital was paid a total of $740,406.41 (the "Austin Capital Transfers" and collectively with the Austin Transfers, the "Transfers"). *See id.*

Austin also submitted three proof of claims in the Bankruptcy Case: (1) $300,000.00 for awarded but unpaid bonuses; (2) $301,190.56 for deferred executive compensation, and (3) $1,535 for unreimbursed expenses (the "Proof of Claims"). *See id.* at ¶ 258; Bankruptcy Case Claims Register Nos. 38-40.

D. The Trustee's Claims.

In the Complaint, the Trustee seeks to recover from the Individual Defendants for their breaches of fiduciary duties and their fraudulent behavior related to selling securities. He also seeks to recover the Transfers illegally paid to Austin, Austin Capital, and the other Defendants and to disallow or subordinate any claims that the Defendants might have. Accordingly, the Trustee alleges 19 claims in the Complaint (the "Trustee's Claims"). The Trustee's Claims include: one claim for breach of fiduciary duty against Austin and the other individual defendants (Claim 1); eight claims against Austin and the individual defendants related to misstatements and omissions in the CAREIC PPM, CAS PPM, and CASDF PPM, including violations of state securities laws, securities fraud under section 10(b), control person liability, common law fraud, negligent misrepresentation, civil conspiracy, and violation of state RICO Statutes (Claims 2-8) (the "Fraud Claims"); Avoidance and recovery of fraudulent and

[6] A copy of the Austin Consulting Agreement is attached as Exhibit 2 to the *Declaration of David Olsky*, Docket No. 14-2.

preferential transfers to Austin and Austin Capital (Claims 9-15) (the "Transfer Claims"); Disallowance of Austin's Proof of Claims (Claim 16); Subordination of Austin's Proof of Claims (Claim 17); and constructive trust (Claim 18) and unjust enrichment and disgorgement (Claim 19).

ARGUMENT

I. THE TRUSTEE'S CLAIMS ARE NOT SUBJECT TO ARBITRATION

Relying on the "liberal federal policy favoring arbitration" and the general presumption that the Trustee stands in the shoes of the debtor, Austin argues that all of the Trustee's Claims arise from the CAREIC Operating Agreement and are thus subject to the Arbitration Clause found therein. But in arguing that the Trustee is bound by the Arbitration Clause, Austin ignores other language in the CAREIC Operating Agreement prohibiting him, as a purported creditor, from enforcing any provision therein. Austin also ignores the true parties to the CAREIC Operating Agreement and that the majority of the Trustee's Claims are not covered by it.

A. As a Purported Creditor of the Debtors, Austin Cannot Seek to Enforce the Arbitration Clause.

In moving to compel arbitration and seeking to enforce the Arbitration Clause, Austin ignores an operative provision of the CAREIC Operating Agreement. Section 15.14 of the CAREIC Operating Agreement states that "None of the provisions of this Agreement shall be for the benefit or enforceable by any creditors of the Company." The CAS Operating Agreement and CASDF Operating Agreement have identical clauses. CAS & CASDF Operating Agreements § 15.14.

Austin filed the Proofs of Claims in the Bankruptcy Case, making him a purported creditor of the Debtors. As a purported creditor, Austin cannot seek to enforce the Arbitration Clause. Austin may not attempt to use one section of the CAREIC Operating Agreement for his benefit while ignoring the sections that are detrimental to him. Accordingly, Austin may not compel arbitration of the Trustee's Claims.

B. The Debtors' *Investors* Did Not Agree to the Arbitration Clause.

Austin frames the CAREIC Operating Agreement and the Arbitration Clause as an agreement between CAREIC and Austin. But the relevant question, at least as it pertains to the Trustee's Fraud Claims, is whether there was any agreement to arbitrate between Austin and the Debtor's investors.

Whether an agreement to arbitrate exists "is simply a matter of contract between the parties." *Walker v. BuildDirect.com Techs., Inc.*, 733 F.3d 1001, 1004 (10th Cir. 2013). Here, Austin does not even contend that the investors (in whose shoes the Trustee stands) agreed to arbitrate their claims. The investors were not parties to the CAREIC Operating Agreement or the Arbitration Clause and thus cannot be bound by it. *See Bellman v. I3Carbon, LLC*, 563 F.Appx. 608, 613-15 (10th Cir. 2014). "[A] party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Spahr v. Secco*, 330 F.3d 1266, 1269 (10th Cir. 2003). And, the general presumption in favor of arbitration disappears when the parties dispute the presence of a valid arbitration agreement. *Dumais v. Am. Golf Corp.*, 299 F.3d 1216, 1220 (10th Cir. 2002).

The only basis on which Austin could content that individual investors agreed to arbitration is that the form "Subscription Agreement" in the CAREIC PPM purports to incorporate the CAREIC Operating Agreement. *See* Exhibit C to the CAREIC PPM. But Austin has not even attempted to show that the investors actually signed this agreement. Doing so must await discovery, investor by investor. For purposes of the current argument, the more fundamental point is that even if individual investors did sign the subscription agreement, that is insufficient to show that they entered an arbitration agreement.

Under California and Nevada law, a party cannot consent to a provision that it did not know existed. *See Windson Mills, Inc. v. Collins & Aikman Corp.*, 101 Cal.Rptr. 347, 351 (Cal. App. 1972); *Cayanan v. Citi Holdings, Inc.*, 928 F.Supp.2d 1182, 1196 (S.D. Cal. 2013) (Nevada law). For a party to consent to an arbitration provision, it must be conspicuous. *See Cayanan*, 928 F.Supp.2d at 1196 ("an arbitration clause must at least be conspicuous and clearly put the other party on notice that he or she is waiving important rights under Nevada law."); *Windson Mills*, 101 Cal.Rptr. at 351. No showing has been made that the Debtors' investors knew they were consenting to the Arbitration Clause. The Arbitration Clause was the last paragraph of the CAREIC Operating Agreement and appeared in the same font and typeface as the rest of the provisions in the CAREIC Operating Agreement. The subscription agreement in the CAREIC PPM makes no mention of the Arbitration Clause and does not give CAREIC's investors notice that they are waiving important rights.

There is even less basis for claiming that CASDF and CAS investors agreed to arbitration. The CASDF PPM and the CAS PPM incorporated only their respective operating agreements, neither of which contained an arbitration provision. The fact that CAREIC was the managing member of CASDF and CAS hardly gave them notice of a provision in the CAREIC Operating Agreement. Accordingly, because Austin has not shown that the investors signed the Arbitration Agreement, and because it was not conspicuous to Debtor's investors, they may not be bound by it.

C. The Trustee's Ninth through Nineteenth Claims are Not Subject to Arbitration.

The majority of the Trustee's Claims are not subject to arbitration for another reason. Claims for fraudulent and preferential transfers, disallowance of claims, subordination, and the

like are not subject to arbitration—even if there is an arbitration agreement to which the debtor was a party. *Allegeart v. Perot*, 548 F.2d 432, 436 (2d Cir. 1977); *see also In re Oakwood Homes Corp.*, 2005 WL 670310 (Bankr. D. Del. 2005) (claims under sections 547 and 548 not subject to arbitration). This is because such claims "are statutory causes of action belonging to the trustee, not to the bankrupt, and the trustee asserts them for the benefit of the bankrupt's creditors, whose rights the trustee enforces." *Id.* The very case upon which Austin relies to seek to bind the Trustee to the Arbitration Clause, explains that because these types claims are not derivative from the debtor who was a party to the arbitration agreement, the Court may not compel them to be submitted to arbitration. *Hays & Co. v. Merrill Lynch*, 885 F.2d 1149, 1153-55 (3d Cir 1989) ("there is no justification for binding creditors to an arbitration clause with respect to claims that are not derivative from one who was a party to it.").

Thus, the Trustee's Ninth through Nineteen Claims cannot be arbitrated regardless of the validity or enforceability of the Arbitration Clause.

II. <u>THE TRUSTEE'S COMPLAINT STATES CLAIMS AGAINST AUSTIN.</u>

Austin moves to dismiss the Trustee's Claims under Rule 12(b)(6) of the Federal Rules of Civil Procedure. In so doing, Austin attempts to morph the 12(b)(6) standard into something that it is not—an exacting standard that requires the Trustee to plead detailed facts and to prove his case in the Complaint, rather than at trial. In fact, to withstand a motion to dismiss, the Trustee need only show that the allegations in the Complaint "state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). The Supreme Court has explained that "[s]pecific facts are not necessary." *Erickson v. Pardus*, 551 U.S. 89, 93 (2007). And "the [complaint] need only give the defendant

fair notice of what the . . . claim is and the grounds upon which it rests." *Id.*; *Smith v. United States*, 561 F.3d 1090, 1104 (10th Cir. 2009). "At the motion-to-dismiss stage, [the court] must accept all the well-pleaded allegations of the complaint as true and must construe them in the light most favorable to the plaintiff." *Thomas v. Kaven*, 765 F.3d 1183, 1190 (10th Cir. 2014).

In ruling on a motion to dismiss, the Court is limited to the facts pled in the complaint. *Burnham v. Humphrey Hospitality Reit Trust, Inc.*, 403 F.3d 709, 713 (10th Cir. 2005). If the Court relies on material outside of the complaint, it must convert the motion to dismiss into a motion for summary judgment. *Id.* If it does so, it "must provide the parties with notice so that all factual allegations may be met with countervailing evidence." *Id.* Here, Austin has filed two declarations in conjunction with the Motion—one from Austin himself, Docket No. 13, and one from his attorney, David Olsky, Docket No, 14. These declarations include numerous documents not referenced in, attached to, or incorporated by reference in the Complaint. The Court should not consider this extraneous material without permitting the Trustee to conduct discovery.

A. The Trustee's Complaint States a Claim for Breach of Fiduciary Duty.

1. Austin Owed Fiduciary Duties to CAREIC from the Beginning.

Austin's first argument for dismissal of the Trustee's breach of fiduciary duty claims is his assertion that *he had no fiduciary duty* to CAREIC or its investors whatsoever, until he became CEO in November 2010. Motion, at 9-10. Austin advances this argument despite the fact that the Complaint alleges (i) he was Senior Vice President of Business Development; (ii) was a member of CAREIC's Board of Directors; and, (iii) he was the person principally responsible for managing "Debtors' capital-raising activities, comprised of selling securities to

the public through unlicensed broker-dealers by means of material misstatements and omissions." Complaint, ¶ 23.

According to Austin, none of CAREIC's officers or directors (except Cochran) had any fiduciary duties at all. Motion, at 9. This is not, and cannot be the case. Austin's argument is wrong and should be rejected for two reasons.

First, Austin's argument cites and is based on the California Revised Uniform Limited Liability Company Act (the "Revised Act"). *See* Motion at 9-10 (citing Cal. Corp. Code §§ 17704.09(c) and (f)(3)) That statute did not become effective until January 1, 2014—long after CAREIC was formed, and long after the transactions, events, and occurrences giving rise to the Complaint.[7] CAREIC was formed in April 2004. As such, it is governed by the Beverly-Killea Limited Liability Company Act (the "Beverly-Killea Act"), which was adopted in 1994. *See* Cal. Corp. Code § 17000 (repealed).[8]

Second, the fundamental premise of Austin's argument – that only a person designated as a "manager" in the company's operating agreement has a fiduciary duty—is not supported by any provision of either the Beverly-Killea Act or the Revised Act. The provision of the Revised Act that Austin relies upon for his assertion that he has no fiduciary duties states only that members do not have fiduciary duties when they act solely as members:

[7] *See* Cal Corp. Code §17713.04(a) & (b) (explaining that the Revised Act applies only to LLC's existing on or after January 1, 2014 or to acts or transactions occurring thereafter).

[8] The Beverly-Killea Act's provisions regarding management and fiduciary duties differ from the Revised Act in important ways. For instance, under the Beverly-Killea Act, "[t]he fiduciary duties a manager owes to the limited liability company and to its members are those *of a partner to a partnership* and to the *partners of the partnership*." Cal. Corp. Code § 17153 (repealed).

> Except as otherwise provided, a member does not have any fiduciary duty to the limited liability company or to any other member *solely by reason of being a member*.

Revised Act, Cal. Corp. Code §17704.09(f)(3) (emphasis added); *see* Motion, at 10.

But that is not support for the proposition that members do not have fiduciary duties when they act in other capacities.[9] Indeed, California law generally ascribes fiduciary duties to persons or entities who in fact participate in the management of the company, regardless of the form of the business organization. So, for instance, in a manager-managed limited liability company, when a member participates in the management of the company, the member will have fiduciary duties. *See Am. Master Lease LLC v. Idanta Partner, Ltd.*, 171 Cal.Rptr. 3d 548 (Cal. Ct. App. 2014) (noting that the operating agreement named a managing member but management authority was given to others as well); *see also ULQ, LLC v. Meder*, 666 S.E.2d 713, 721 (Ga. App. 2008) ("members of manager-managed LLCs owe no fiduciary duties, *except to the extent that they participate in management*." (emphasis added). Similarly, in a limited partnership limited partners have fiduciary duties when they take actions affecting the governance of the limited partnership. *KE Prop. Mgmt. v. 275 Madison Mgmt. Corp.*, CivA 12683, 1993 WL 285900 (Del. Ch. July 27, 1993) ("to the extent a partnership agreement empowers a limited partner discretion to take actions affecting the governance of the limited partnership, the limited partner may be subjection to the obligations of a fiduciary").

Austin had fiduciary duties to CAREIC. The Complaint alleges that CAREIC did not recognize the term "manager," or use it in its operations. Instead, CAREIC had "officers." In

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[9] Both the Beverly-Killea Act and the Revised Act recognize that limited liability companies may have "officers," and that officers "may, but need not, be a member or manager of the limited liability company." Cal. Corp. Code § 17154 (repealed); *see also id*. § 17704.07.

particular, it had among others, a CEO (Cochran), a President (Robert Geringer),[10] a CFO (Child), and a President or Senior Vice President of Worldwide Business Development (Austin). Complaint ¶¶ 22, 23 & 26.

The Complaint alleges that Austin had substantial management responsibility for the Company: he was the person principally responsible for managing "Debtors' capital-raising activities, comprised of selling securities to the public through unlicensed broker-dealers by means of material misstatements and omissions." Complaint, ¶ 23. He oversaw CAREIC's entire sales force and was in charge of supervising and effecting CAREIC's sales of securities. *Id.* at ¶¶ 174-75. The CAREIC PPM even describes his integral role in CAREIC: "Mr. Austin recently led Castle Arch's sales teams through the initial capitalization of the company. He continues to guide and shape the international team in delivering highly appealing structured secured investment offerings." CAREIC PPM at 27.

The Complaint also alleges that—although no such structure is recognized under the Beverly Killea Act—CAREIC in fact had a "Board of Directors" which it held out to the public as being ultimately responsible for the direction and management of the Company. *See* Complaint ¶¶ 22, 23, 25, 27 & 28; CAREIC PPM at 26-28. Austin was a member of CAREIC's Board of Directors. Complaint ¶ 23.

For these reasons, Austin necessarily owed fiduciary duties to the Debtors from the beginning.

2. Austin Continued to Breach his Fiduciary Duties to CAREIC After he Became CEO.

Austin's next argument is a simple misrepresentation of the Complaint. Austin claims

[10] Geringer is not identified by name in the current Complaint.

that only "ten paragraphs [of the Complaint] relate to Mr. Austin's management of CAREIC after he became CEO in November of 2010." Motion, at 10. To make this claim, he must act as if the only fiduciary breaches alleged against him in the Complaint are those that relate to his failure to renew and/or make a claim on the Axis Policy. *Id.* In fact, there are over 50 additional paragraphs in the Complaint alleging breaches of fiduciary duties that were ongoing before Austin became CEO and that continued thereafter. *See* Complaint, at ¶¶ 134-186.

These allegations include breaches of fiduciary duties related to lack of board oversight, *id.* at ¶¶134-137; lack of officer diligence, *id.* at ¶¶ 138-143; lack of internal control and reporting procedures, *id.* at ¶¶ 144-146; reckless spending of investor funds through 2011, *id.* at ¶¶ 147-158; mismanaging the CAOP entities, *id.* at ¶¶ 159-168; allowing an individual who was statutorily banned by the SEC to be involved in the sales of Debtors' securities throughout, *id.* at ¶¶ 169-172; and illegal sales of Debtors' securities by unlicensed broker dealers, *id.* at ¶¶ 173-186. Reading the Complaint in the light most favorable to the Trustee, these allegations alone prevent the Court from dismissing the Trustee's breach of fiduciary duty claims.

The bulk of Austin's argument that he did not breach his fiduciary duty as CEO is focused on the Trustee's allegations concerning the failure to make a claim on or to renew the Axis Policy. Austin starts this argument with a tedious interpretation of the Axis Policy which is laden with contested facts.[11] Motion, at 10-11. Austin's argument also requires the Court to

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[11] For instance, Austin claims that the Axis Policy prescribed a particular "order of priority" in paying claims under the Policy. Motion, at 10. But the language of the Policy itself establishes no such priority. *See* Policy ¶ 1.A. through 1. D. Similarly, Austin claims that AXIS had "no further obligation to renew the policy," *id.*at 1, but ignores the language of Section VI, providing that if any insured gives the carrier notice of circumstances which could give rise to a claim, and the carrier must treat any subsequent Claim relating to those circumstances as have been made in the Policy Period. *Id.* ¶ VI.

accept Austin's version of facts related to separate insurance policy he claims CAREIC had with a different carrier—Rockhill Insurance Company (the "Rockhill Policy"). *Id*. at 11. Neither of these insurance policies is attached to the Complaint, incorporated into it by reference, or even relied upon in the Complaint.[12] As such, Austin's arguments based on his interpretation of these documents are improper on a motion to dismiss. *See Prager v. LaFaver*, 180 F.3d 1185, 1189 (10th Cir. 1999) (upholding district court's decision not to consider extrinsic evidence on motion to dismiss). On a motion to dismiss, the Court must accept the allegations of the Complaint, and interpret them in the light most favorable to the non-moving party. *Thomas v. Kaven*, 765 F.3d 1183, 1190 (10th Cir. 2014). Austin's complex chain-of-causation argument requires the Court to do the opposite and should not be accepted.

Moreover, the heart of Austin's argument—that the Trustee has not identified a "claim" against CAREIC of which Austin was aware—is directly contradicted by paragraph 196 of the Complaint. It alleges that

> 196. At the time these Officers removed CAREIC from the Policy and decreased coverage by $4 million, they were aware, or should have been aware, of "Claims" made against them under the Policy. Specifically, during the Policy Period, CAREIC received numerous oral and written requests, demands and expressions of concern relating to the Debtors' operations and Management. Many of these communications included allegations of mismanagement, breaches of fiduciary duties, and material misrepresentations in the solicitation of investments.

Viewing this allegation in the light most favorable to the Trustee, the Court may infer that Austin was aware of circumstances requiring him to make a Claim on the Axis Policy and the benefit in renewing the Axis Policy at the $5 million Limit of Liability rather than the reduced $1 million

[12] In fact, Austin does not even attempt attach a copy of the Rockhill Policy to either of the two declarations that he improperly submitted in conjunction with the Motion.

Limit of Liability.

Finally, Austin contends that the Trustee does not allege that CAREIC was damaged by his failure to renew the Axis Policy for the entire $5 million. But the very reduction of the Axis Policy in light of the Complaint seeking relief in excess of $1 million and a related interpleader proceeding in which the CAREIC officers and directors are litigating the allocation of the Axis Policy and all have alleged that the Axis Policy is insufficient to cover all claims, *see Axis v. Cochran*, 14-cv-244-DAK (D. Utah), is sufficient to show damage. And while the Trustee disputes that Austin's chain-of-causation argument is correct, it requires inferences that are not appropriate at this stage. Instead, taking the allegations in the complaint as true and ignoring facts and documents outside of the Complaint, the Trustee's claim for breach of fiduciary duty must stand.

B. The Trustee States Claims for Fraud and Negligent Misrepresentation (Claims 2-8).[13]

Austin groups together the Trustee's Fraud Claims, alleging that they have the same elements and requirements. But these seven claims have separate requirements and do not all require the same heightened pleading standard that Austin alleges.

1. The Trustee Alleges that Austin Made a Statement for the Purposes of Claims 2-8.

Austin makes three principal arguments relating to the Trustee's allegations of Austin's material misstatements and omissions in the PPMs: (1) the Trustee did not allege the Fraud Claims with the requisite level of specificity; (2) Austin did not "make" the statements at issue;

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[13] At the outset, Austin argues that the Trustee lacks standing to bring these claims because of the *in pari delicto* doctrine. But the *in pari delicto* doctrine does not apply to corporate insiders or partners, such as Austin. *See Goldin v. Primavera Familienstiftung, Ltd. (In re Granite Partners, L.P.)*, 194 B.R. 318, 332 (S.D.N.Y. 1996).

and (3) the Trustee did not allege any specific investors that relied on Austin's statements. Each of these arguments, however, misconstrues applicable law and, therefore, must fail.

Austin first argues that the Trustee did not plead the Fraud Claims with the requisite level of specificity required by Rule 9(b) of the Federal Rules of Civil Procedure. But Rule 9(b) is not as exacting as Austin makes it out to be. Rule 9(b) states that "[i]n alleging fraud or mistake, a party must state with particularity, the circumstancing constituting fraud or mistake." Its purpose is simply "to afford defendant fair notice of plaintiff's claims and the factual ground upon which they are based." *Lemmon v. Envirocare, Inc.* 614 F.3d 1163, 1172 (10th Cir. 2010).[14]

The Trustee's fraud allegations clearly satisfy Rule 9(b)'s particularity requirement. This is not a case like *Koch v. Koch Industries, Inc.*, 203 F.3d 1202 (10th Cir. 2000), (relied upon by Austin) where the plaintiff alleged only that "during 1982 and continuing to the present time, defendants planned and acted to conceal the true value of shares of stock . . . by failing to disclose the existence, location, ownership, condition and true value of assets and property. . . ." *Id*. at 1236. The Tenth Circuit understandably held this kind of allegation was not specific enough to satisfy Rule 9(b). It does not provide any specifics regarding the statements. *Id.* at 1237.

In this case, by contrast, the Trustee alleges the fraud in great detail. The Trustee lays out each omission and material misstatement from the PPMs in detail in paragraphs 198 to 243 of the Complaint. In these paragraphs, the Trustee states the date of each PPM and the relevant omission and material misstatement. These allegations adequately plead the "who, what, and

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[14] Moreover, contrary to Austin's assertion, the Trustee's claim for negligent misrepresentation (Claim 6) does not require this heightened pleading standard—"[u]nlike claims alleging fraud, claims for negligent misrepresentation are governed by Rule 8's liberal pleading standard." *Touchstone Grp., LLC v. Rink*, 913 F.Supp.2d 1063, 1084 (D. Colo. 2012).

where" for the purposes of Rule 9(b). *See Ouaknine v. MacFarlane*, 897 F.2d 75, 80 (2d Cir. 1990). Indeed, other courts have found that "reference to an offering memorandum satisfies Rule 9(b)'s requirement of identifying time, place, speaker and content of representation where . . . defendants are insiders or affiliates participating in the offer of securities." *See id.*

Next, relying only on *Janus Capital Group v. First Derivative Traders*, 131 S. Ct. 2296 (2011), Austin contends that because the PPMs were technically published by CAREIC and do not identify any specific individual as the drafter, he cannot be liable for making the statements contained or omitted therein. This argument, however, mischaracterizes the PPMs, misinterprets *Janus* and its progeny, and completely ignores the Trustee's claim for control liability.

In *Janus*, the Supreme Court held that a mutual fund investment advisor was not the "maker" of a material misstatement in a securities offering because it did not have ultimate authority over the statement. *Id.* at 2302. According to the Court, "[f]or the purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id. Janus* is inapplicable to this case.

First, *Janus* only applies to outside individuals or entities, not to corporate insiders such as Austin.[15] If *Janus* precluded such claims against corporate insiders, it would essentially

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[15] *In re Pfizer Inc. Sec. Litig.*, 936 F.Supp.2d 252, 269 (S.D.N.Y. 2013) ("*Janus* addressed only whether *third parties* can be held liable for statements made by their clients. Its logic rested on the distinction between secondary liability and primary liability . . . and has no bearing on how corporate officers who work together in the same entity can be held jointly responsible on a theory of primary liability."); *Local 703, I.B. of T. Grocery & Food Emps. Welfare Fund v. Regions Fin. Corp.*, No. Civ10-2847, 2011 WL 12627599, at *1 (N.D. Ala. Aug. 23, 2011) (unpublished) ("Nothing in *Janus* stands for the proposition that CEOs and CFOs cannot be liable for false and misleading statements in their own company's financial statements"); *SEC v. Daifotis*, 874 F.Supp.2d 870, 881 (N.D. Cal. 2012) ("The Court is persuaded that in the wake of

absolve corporate insiders of primary liability for all securities fraud claims because ultimately, all statements are within the control of the company that employs them. *In re Merck & Co, Inc. Sec. Derivative, & ERISA Litig.*, No. Civ-05-1151, 2011 WL 3444199, at *25-26 (D.N.J. Aug. 8, 2011) ("[*Janus*] certainly cannot be read to restrict liability for Rule 10b-5 claims against corporate officers to instances where a plaintiff can plead, and ultimately prove, that those officers—as opposed to the corporation itself—had 'ultimate authority' over the statement."). Moreover, even if *Janus* applied to bar the Trustee's allegation that Austin "made" the statements in the PPMs, *Janus* applies only to claims under Rule 10b-5, and does not bar the Trustee's additional claims for control liability, state law securities fraud, common-law fraud, negligent misrepresentation, civil conspiracy or state-law RICO violations. *See In re Optimal U.S. Litig.*, 837 F.Supp.2d 244, 262-63 (S.D.N.Y. 2011); *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F.Supp.2d 1164, 1186 (C.D. Cal. 2011) (refusing to extend *Janus*'s "maker" standard to common law fraud). Austin's argument also ignores the Trustee's claim for control person liability under 15 U.S.C. § 78t(a) (Claim 4), which provides for joint and several liability for every person who directly or indirectly controls any person liable for securities fraud. Even if Austin did not "make" the statements in the PPMs, he is still liable as a control person.

Notwithstanding *Janus*'s inapplicability, Austin was the maker of the statements in the CAREIC PPM. Although there is no specific signatory, Austin is listed on the CAREIC PPM as the person to contact for additional information and is the only individual so listed. CAREIC PPM, at 48. As such, even under *Janus*, the statements are attributable to him. *See Janus*, 131 S.

Janus, an executive who indisputably exercised authority over his own non-casual statements with the intent and reasonable expectation that such statement would be relayed to the investing public, should be deemed to be the person who 'made' the statements to the investing public . . . .").

Ct. at 2302.

Lastly, without citing any precedent requiring as much, Austin faults the Trustee for failing to name a specific investor who relied on Austin's statements. Such specificity is not required at this stage and would do nothing to heighten Austin's notice of his illegal conduct and the claims against him. The Trustee pled that all investors have transferred all of their claims to the Trustee. Complaint, at ¶ 16. Their names are not relevant at the pleading stage. Rather, the identity of the particular investors is a matter of proof—not pleading. The Trustee has pled sufficient facts to give Austin fair notice of the statements at issue, when they were made, and where they appear in the relevant documents. The Trustee has thus alleged sufficient facts to withstand the Motion to Dismiss on this ground.

2. The Trustee Sufficiently Pleads Reliance.

Austin contends that the Trustee did not allege that any investor relied on Austin's misstatements or omissions. But, as the statements in the PPMs are primarily omissions,[16] under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), the Court must presume that the investors relied on the omissions and misstatements. *See Joseph v. Wiles*, 223 F.3d 1155, 1162 (10th Cir. 2000) (explaining that in "mixed cases" the court must establish a unitary burden of proof on the reliance issue based on whether the offenses alleged can be characterized primarily as omissions or misrepresentations). Even ignoring this presumption, the Trustee nevertheless pleads reliance. He states:

> ¶ 286. The Debtors' investors reasonably relied upon the accuracy of Management's representations in making their decisions to invest, and would not have made the investments at the price paid, if at all, had they known the truth of

[16] A review of the Complaint indicates approximately 17 alleged omissions in contrast to only six alleged misstatements. *See* Complaint, at ¶¶ 198-243.

the material misrepresentations and omissions in the above offerings.

> ¶ 296. The investors in the relevant offerings reasonably relied on the accuracy of Management's representations in making their decisions to invest, and would not have made the investments at the price paid, if at all, had they known the truth of the material misrepresentations and omissions.
>
> ¶ 330. The investors in the relevant offerings reasonably relied upon the statement and have made substantial payments to the Debtors as a result of the misrepresentations.
>
> ¶ 358. The relevant investors reasonably relied upon the statements and invested substantial sums of money in the Debtors as a result of the misrepresentations.

Austin does not attempt to argue that these statements are insufficient to prove reliance at the motion-to-dismiss stage, nor does he state what else the Trustee should have pled to allege reliance. Requiring a higher pleading standard would essentially require the Trustee to prove his case at the pleading stage. This is not what Rule 12(b)(6) demands. Accordingly, the Court should not dismiss the Trustee's Fraud-type claims for failure to plead reliance.

C. The Trustee States Plausible Claims for Avoidance and Recovery of Fraudulent Transfers (Claims 9-15).

1. The Trustee States a Plausible Claim for Fraudulent Transfers Made With Actual Intent to Hinder, Delay or Defraud (Claims 9, 11, and 15).

Relying almost entirely on cases from the Southern District of New York, Austin moves to dismiss the Trustee's Claims 9 and 11 for avoidance and Claim 15 for recovery of fraudulent transfers made or incurred by the Debtors on the basis that the Trustee fails to satisfy heightened pleading standards allegedly applicable for proving that the Transfers made or obligations incurred to Austin were fraudulent under the Bankruptcy Code and the Utah Fraudulent Transfer Act (the "UFTA") as having been made or incurred "with actual intent to hinder, delay or defraud[.]" 11 U.S.C. § 548(a)(1)(A); UFTA § 25-6-5(1)(a) (made applicable in bankruptcy under 11 U.S.C. § 544(b)). This argument is without merit.

Under Rule 9(b) of the Federal Rules of Civil Procedure, a party must state with particularity the circumstances constituting fraud, but intent, knowledge, and other conditions of a person's state of mind may be alleged generally. The pleadings need only "afford defendant fair notice of plaintiff's claims and the factual ground upon which they are based." *Lemmon*, 614 F.3d at 1172. "The portions of the accusation involving . . . intent . . . only need to be alleged generally, which means they only need to be plausible under . . . Rule 8." *Osborn v. Brown*, No. 12-cv-775, 2013 WL 1411781, at *3 (D. Utah Apr. 8, 2013) (unpublished).

Austin literally ignores these rules as well as explicit and well-settled law in the Tenth Circuit permitting the Court to infer actual intent to defraud based on the presence of one or more "badges of fraud" established under UFTA § 25-6-5(2).[17] *See Taylor v. Rupp (In re Taylor)*, 133 F.3d 1336, 1339 (10th Cir. 1998); *accord United States v. Simons*, No. 06-cv-750, 2009 WL 4348331, at *9 (D. Utah Sept. 30, 2009) (unpublished). He also ignores the important rule that a bankruptcy trustee, who is "an outsider to the transaction who must plead fraud from second-hand knowledge[,]" enjoys a lessened burden for setting forth facts alleging fraudulent intent. *Wagner v. Pruett (In re Vaughan Co., Realtors)*, 477 B.R. 206, 217-18 (Bankr. D. N.M. 2012); *Picard v. Cohmad Sec. Corp. (In re Bernard L. Madoff Invest. Sec., LLC)*, 454 B.R. 317, 319 (Bankr. S.D.N.Y. 2011).

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[17] This section states, in relevant part, that:

> "To determine 'actual intent' . . . , consideration may be given, among other factors, to whether:
> (a) The transfer or obligation was to an insider;
> …
> (h) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
> (i) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation incurred. . . ."

Applying these standards, the Trustee, a liquidating trustee in bankruptcy, has sufficiently pled facts that establish circumstances constituting fraud and to infer fraudulent intent. The Complaint makes painstakingly clear that the Debtors were operated with a general disregard for corporate formalities and in breach of fiduciary duties, and that the Defendants raised funds from investors through fraudulent acts. *See* Complaint ¶ 14 & Exh. 1. Furthermore, the Trustee has expressly alleged several badges of fraud, including that the Transfers made or obligations incurred by the Debtors to Austin were made to Austin as a statutory insider (Complaint ¶250),[18] they were made or incurred at a time when the Debtors were insolvent, (Complaint ¶251) and that Transfers were made or the obligations were incurred for less than reasonably equivalent value. The Complaint expressly alleges that Austin oversaw all of the Debtors' sales of securities (Complaint ¶¶ 174-75), he solicited investors, advised investors on the merits of investing in the Debtors, and regularly effected transactions in the Debtors' securities (*id*). All of this was done when Austin (as well as many of the persons he was supervising) was not licensed to deal in securities (and despite express representations in the PPMs that salespersons were licensed). Complaint ¶¶ 176; CAREIC PPM, at 2. The Complaint makes clear that the Debtors continued to make Transfers and incur obligations long after it was clear that their underlying real estate projects were failures—and that an exorbitant percentage of the funds raised went to Austin's fundraising machine. Complaint ¶ 14 & Exh. 1. As discussed below this cannot be reasonably equivalent value.

Accordingly, the Trustee has alleged sufficient facts, with the sufficient level of particularity to state Claims 9 and 11for the avoidance fraudulent transfers and for recovery of

[18] *See* 11 U.S.C. § 101(31); UFTA § 25-6-2(7).

those avoidable transfers in Claim 15. The Motion must be denied as to these Claims.

2. The Trustee States Plausible Claims for Avoidance and Recovery of Constructive Fraudulent Transfers (Claims 10, 12, 13, and 15).

A transfer made or an obligation incurred is avoidable under 11 U.S.C. §§ 548(a)(1)(B) and UFTA §§25-6-5(1)(b) & 25-6-6(1) if it was made or incurred for "less than reasonably equivalent value." Austin maintains that the Trustee's Claims 10, 12, 13 and 15 seeking to avoid and recover the Transfers or the obligations that gave rise to those Transfers must be dismissed because he was entitled to a salary and provided services and, thus, he provided "reasonably equivalent value." But this is clearly not the case under the facts pled by the Trustee, which must be deemed true for purposes of this Motion, and applicable Utah precedent.

The Trustee has pled that Austin was in charge of fundraising, that he was not licensed to deal in securities and that this activity was illegal. Complaint ¶¶ 77-80, 176-77. Specifically, this activity was in violation of Utah Code Ann. §§ 61-1-3 & 61-1-22 and Cal. Corp. Code §§ 25210, which make it illegal to conduct business as a broker-dealer without the proper licensure. Furthermore, the Trustee has pled that many of the individuals that Austin was supervising were not licensed. *Id*. ¶¶ 176-77. The Debtor incurred obligations to Austin to compensate him for illegal behavior and the Transfers that were made to him arose out of this improper obligation and were, in part, to compensate Austin for his own illegal sales of securities.

These facts, which must be deemed true, establish grounds for avoidance of the Transfers. Specifically, this Court has made it clear that any salary or commission obtained from an illegal contract is deemed to be a constructive fraudulent transfer, and that an unlicensed defendant who obtains a salary or commissions for selling securities may not benefit from his illegal conduct. *See Miller v. Taber*, No. 12-cv-74, 2014 WL 317938, at *3 (D. Utah Jan. 29,

2014) (unpublished); *see also See Wing v. Dockstader*, No. 08-cv-776, 2010 WL 5020959, at *6 (D. Utah Dec. 3, 2010) (unpublished). In short, illegally rendered services and transfers made related to such services cannot be deemed to be "reasonably equivalent value."

Ignoring this hurdle, Austin (again relying primarily on law that is not binding on this Court) argues that "reasonably equivalent value" exists because (1) he provided value, and (2) the Transfers were payments of salary which are "presumed" to be in exchange for reasonably equivalent value. Motion at 19-20. Austin misses the point—salary illegally paid cannot be reasonably equivalent value. But, even so, whether he gave "value" and such value was "reasonably equivalent value" is clearly a question of fact. *See, e.g., Pension Transfer Corp. v. Beneficiaries (In re Fuehauf Trailer Corp.)*, 444 F.3d 203, 212-13 (3d Cir. 2006); *Jacobs v. Altorelli (In re Dewey & LeBoeuf LLP)*, 518 B.R. 766, 784-85 (Bankr. S.D.N.Y. 2014); *Merrill v. Allen (In re Universal Clearing House)*, 60 B.R. 985, 998 (D. Utah 1986) ("a finding of less than a reasonably equivalent value is a finding of fact"). And such a factual determination is inappropriate at this stage. *In re Bernard L. Madoff Inv. Sec. LLC*, 458 B.R. 87, 113 (Bankr. S.D.N.Y. 2011) ("[T]he Court need not make a finding as to whether the Defendants' services constituted adequate value, as these issues often involve factual inquiries inappropriate for a motion to dismiss."); *Silverman v. Actrade Capital, Inc. (In re Actrade Fin. Techs. Ltd.)*, 337 B.R. 791, 804 (Bankr. S.D.N.Y. 2005) (same).

Nonetheless, a review of Austin's two noted points shows that they are without merit. First, Austin argues that his services on behalf of the Debtors provided "value" to the Debtors. In so doing, Austin conflates the term "value" with "reasonably equivalent value" and ignores that the issue of reasonably equivalent value presents two questions: "First, did the transferee

give value? Second, if the transferee did give value, was the value given reasonably equivalent to the value of the transferred property." *Universal Clearing House*, 60 B.R. at 998. For reasons already discussed, Austin could not have provided "value" to the Debtors because he was not licensed to sell securities, much less to supervise others to do so. Each transaction that Austin facilitated or oversaw was an illegal voidable transaction that exposed the Debtors to additional liabilities. And, even if it could somehow be argued that Austin did provide value, the Trustee's allegations create a plausible claim that it was not "reasonably equivalent" value. Austin was not licensed to deal in securities and was paid excessive amounts, at times $15,000.00 per month plus bonuses, to do so. *See* Complaint ¶ 151.

Second, relying on *Universal Clearing House Co.*, 60 B.R. at 985, Austin contends that because the Transfers were salary, he is entitled to a presumption that they were made for reasonably equivalent value. That case, however, actually supports the Trustee's position that the determination or reasonably equivalent value is inappropriate at this time. In that case, this Court, reviewing the issue on appeal, remanded the case to the Bankruptcy Court to make factual findings as to whether the defendant provided reasonably equivalent value. *Id.* at 1000 ("We remand these cases to the bankruptcy court for factual findings on the issue of whether the value of the services provided by appellants were reasonably equivalent to the value of the transfers received."); *see also Pryor v. Tiffen (In re TC Liquidations LLC)*, 463 B.R. 257, 268 (Bankr. S.D.N.Y. 2011) (applying presumption when making findings of fact and conclusions of law). Here, the Trustee has alleged sufficient facts that any value that Austin provided was not reasonably equivalent to the value of the Transfers. Any further analysis and determination of reasonably equivalent value is inappropriate at this stage. The Motion seeking to dismiss claims

10, 12, 13 & 15 must be denied.

3. The Trustee States a Plausible Claim for Avoidance of Preferential Transfers (Claim 14).

Austin argues that Claim 14, seeking to avoid the Transfers made to Austin within the prepetition year as preferential transfers under 11 U.S.C. § 547(b), must be dismissed because: (a) the Trustee allegedly has not pled that Austin is a creditor; (b) the Trustee has not alleged facts stating that the payments payment of an antecedent debt; and (c) Austin provided contemporaneous value in exchange for the Preference Transfers. Again, Austin ignores the Trustee's allegations in the Complaint and his own actions in the Bankruptcy Case, and fails to take into account that the facts pled by the Trustee are deemed true.

The Trustee has pled, albeit in the alternative, that Austin is a creditor. He states that: "To the extent Austin is found to be a creditor, which is denied, each of the Preferential Transfers were made to or for the benefit of a creditor." Complaint, ¶ 409. Austin filed the Proofs of Claims in the Bankruptcy Case and has opposed the Trustee's claim to disallow the Proof of Claims. Accordingly, until those claims are disallowed, Austin is a creditor for the purposes of § 547(b). The Trustee's Claim 16 in the Complaint, seeking to disallow Austin's Proof of Claims, does nothing to change this analysis. Although the Trustee has sought to disallow Austin's Proofs of Claims, he may still allege, and has alleged, that Austin is a creditor for the purposes of § 547(b). *See* Fed. R. Civ. P. R. 8(a)(3) (permitting alternative claims for relief).

The Trustee has also sufficiently alleged that the Transfers were made for or on account of antecedent debt. In the Complaint, the Trustee states: "To the extent Austin is found to be a creditor, which is denied, each of the Preferential Transfers made by the Debtors was made for or

on account of an antecedent debt owed by the Debtors before such Preferential Transfers were made." Complaint ¶ 410. A debt is antecedent "if the debt is incurred prior to the transfer." *In re Ogden*, 243 B.R. 104, 112 (10th Cir. B.A.P. 2000). Courts look to whether the purported creditor had a claim against the purported debtor before the transfer. *Id.* Moreover, unpaid salary constitutes an antecedent debt. *West v. Seiffert (In re Houston Drywall, Inc.)*, No. 06-3415, 2008 WL 2754526, at *14 (Bankr. S.D. Tex. July 10, 2008) (unpublished). Again, Austin has admitted as much by filing the Proof of Claims. He contends that the Proofs of Claims are for payment of, among other things, his unpaid salary. As such, Austin had a claim for the salary payments before they were made and the Trustee has satisfied the antecedent-debt element.

Lastly, Austin contends that he provided contemporaneous new value in exchange for the Preferential Transfers. To prevail on a contemporaneous new value defense, *Austin* must prove that he (1) extended new value to the Debtors; (2) the parties intended the new value and the disputed transfers to be contemporaneous exchanges; and (3) the exchanges were, in fact, substantially contemporaneous.[19] These are factual issues that cannot be decided at this stage, and when Austin presents evidence in an attempt to support his burden, the Trustee will contest that he is entitled to this defense.

D. The Trustee States a Plausible Claim to Disallow or Subordinate Austin's Claim (Claims 16 and 17).

1. Sufficient Facts are Pled Under 11 U.S.C. § 502(b) and (d).

Austin argues that Trustee's Claim 16, seeking to disallow the Proofs of Claim that Austin filed against the bankruptcy estate, should be dismissed. He contends that the Proofs of Claim are entitled to a presumption of *prima facie* validity and the Trustee has not overcome this

[19] 11 U.S.C. § 547(c)(1) & (g) (defendant has burden of proving defenses).

presumption. This is wholly incorrect as a matter of law.

Section 501(a) of the Bankruptcy Code, which governs the filing of claims in a bankruptcy case, states that a creditor may file a proof of claim, and the Federal Rules of Bankruptcy Procedure, which provide procedural rules for filing claims, state that a proof of claim filed in accordance with the Rules constitutes prima facie evidence of the validity and amount of the claim. 11 U.S.C. § 501(a); Fed. R. Bankr. P. 3001(f). Section 502of the Bankruptcy Code, which governs the *allowance* of claims filed in a bankruptcy case, states, in relevant part, that "[a] claim . . . , proof of which is filed under section 501 of this title, is deemed allowed, *unless* a party in interest . . . . objects." 11 U.S.C. § 502(a) (emphasis added). The grounds for objecting to a proof of claim that has been filed under § 501 are set forth, in relevant part, in 11 U.S.C. § 502(b) and (d).

Thus, upon the filing of the Trustee's Complaint seeking disallowance of Austin's Proofs of Claim under §502(b) and (d), Austin's Proofs of Claim were no longer deemed allowed. Although the evidentiary effect of the Proofs of Claim is that the claims asserted are valid, the Trustee may rebut that presumption, and has indicated his intent to do so through the filing the claim objection set forth in the Complaint. *See In re Geneva Steel Co.*, 260 B.R. 517, 524 (B.A.P. 10th Cir. 2001). To say, as Austin seems to do, that a Trustee must overcome this presumption in a complaint, and not at an evidentiary hearing makes no sense and the argument must be rejected.

Furthermore, the facts asserted in the Complaint, all of which must be deemed true, are more than sufficient to notify Austin of the basis for his objection that Austin does not have an

allowable claim against the Debtors, including but not limited to at least the following:[20] Austin was not licensed and therefore could not obtain a salary for selling securities and any obligation to him related thereto is not enforceable against the Debtors or property of the Debtors, 11 U.S.C. § 502(b)(1); Austin's Proofs of Claim assert claims for services of an insider and the claims exceed the reasonable value of such services, 11 U.S.C. §502(b)(4); and Austin is a person from whom "property is recoverable under § 550" and is a "transferee of a transfer avoidable under section . . . 544 . . .547 [or] 548" who has refused to pay back the avoidable transfers, 11 U.S.C. § 502(d). Thus, having pled sufficient facts to support a claim objection under § 502, there is no basis to dismiss Claim 16.

It should be noted that Austin contends that the claim objection under § 502(d) must be dismissed because he has not been held liable for the Transfers. But, as discussed in detail the Trustee's avoidance actions have been properly and sufficiently pled. Having done so, the Trustee has asserted a claim for relief under § 502(d). *See, e.g., Sharp v. CF/SPC NGU, Inc. (In re Commercial Fin. Servs., Inc.)*, 322 B.R. 440 (Bankr. N.D. Okla. 2003) (refusing to dismiss a disallowance claim in light of a pending fraudulent transfer claim and stating: "[b]ecause it is possible that Plaintiffs' Section 502(d) claim may become 'cognizable' after the fraudulent transfer claims are prosecuted to conclusion, the Section 502(d) claim is legitimately joined with the Plaintiffs' other claims . . . and is not subject to dismissal for failure to state a claim.").

2. The Trustee Has Pled Sufficient Facts to Support His Claim for Subordination (Claim 17).

Austin argues that the Trustee's Claim 17, seeking to subordinate pursuant to 11 U.S.C.

[20] The Trustee reserves the right to assert these objections as well as others, including those that may be determined to exist after discovery is completed in this case.

§ 510(c) any claim that Austin may be allowed to assert against the Debtors, must be dismissed because the Trustee failed to plead that the claim arises from "egregious conduct such as gross misconduct tantamount to fraud, misrepresentation, overreaching or spoliation." Motion, at 24 (quoting *In re Castleton's, Inc.*, 990 F.2d 551, 559 (10th Cir. 1993)). Even assuming that this is the appropriate legal standard (which the Trustee expressly maintains is not because Austin is an insider of the Debtors),[21] the Complaint alleges facts giving rise to gross misconduct, fraud, and misrepresentation. Specifically, the Complaint clearly alleges that Austin made numerous fraudulent statements in the PPMs, illegally solicited investors without the proper licenses, breached his fiduciary duties to CAREIC, and misused CAREIC's funds. All of these facts must be deemed true, and they are sufficient to plead subordination under 11 U.S.C. § 510(c).

E. The Trustee States Plausible Claims for Constructive Trust and Unjust Enrichment (Claims 18 and 19).

Austin seeks to dismiss the Trustee's claims for constructive trust and unjust enrichment based on the assertion that (1) the Trustee has not alleged that he does not have an adequate remedy at law; (2) Austin's consulting agreement prevents recovery in quasi-contract; and (3) the Trustee is barred by the doctrine of *in pari delicto*. Motion at 24-25. None of these arguments are well taken.

First, both the Federal Rules and the Utah Rules of Civil Procedure expressly permit a

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[21] "The doctrine of equitable subordination . . . looks not to the substance of the transaction, but to the behavior of the parties involved." *In re Hedged-Investments Associates, Inc.*, 380 F.3d 1292, 1297 (10th Cir. 2004). "[T]he courts seek to remedy some inequity or unfairness perpetrated against the bankruptcy entity's other creditors or investors by postponing the subordinated creditor's right to repayment until others' claims have been satisfied." *Id.* "*Where the claimant is an insider or a fiduciary, the party seeking subordination need only show some unfair conduct, and a degree of culpability on the part of the insider*." *Id.* at 1301 (emphasis added).

plaintiff to plead claims in the alternative. *See* Fed. R. Civ. P. 8(d) and Utah R. Civ. P. 8(e) ("A party may state legal and equitable claims or legal and equitable defenses regardless of consistency."). When faced with legal and equitable claims pled in the alternative, a court may not dismiss the equitable claims on the basis that an adequate remedy at law exists until the court has finally determined the sufficiency of the legal claims. *Miller v. Basic Research, Inc.,* No. 07-cv-871, 2008 WL 4755787, at *8 (D. Utah Oct. 27, 2008) (unpublished). Here, the Trustee pled that he may have no adequate remedy at law. Complaint, at ¶ 419. As he has pled his equitable claims in the alternative, they are not subject to dismissal at this time.

The same principal also negates Austin's quasi-contract argument. *See Northgate Vill. Dev., LC v. Orem City*, 2014 UT App 86, ¶¶ 50-51, 325 P.3d 123 ("Because a claim should be dismissed only if it appears to a certainty that the plaintiff would be entitled to no relief under any state of facts which could be proved in support of the claim, a district court should not dismiss alternative equitable claims if the existence or applicability of a contract remain in dispute." (quotations omitted)). The validity of the Austin's consulting agreement has not been established. Moreover, Austin's consulting agreement does not provide for legal remedies and the Trustee is not seeking to enforce this alleged agreement or claiming a breach thereof. Because none of this has been conclusively established, the alternative claims should be allowed to proceed. *See id.*

Austin also argues that the doctrine of *in pari delicto* bars the Trustee from asserting these equitable claims because he stands in the shoes of the Debtors and is thus equally responsible for the Debtors' misdeeds. But the *in pari delicto* doctrine does not apply to corporate insiders or partners. *Goldin v. Primavera Familienstiftung, Ltd (In re Granite*

Partners, L.P.), 194 B.R. 318, 332 (S.D.N.Y. 1996). "Otherwise, a trustee could never sue the debtor's insiders on account of their own wrongdoing." *Id.* The cases that Austin relies on state as much and both involve suits against outside third parties—a law firm and accounting firms.[22] As the President of Worldwide Business Development, board member, and CEO, Austin was an insider of CAREIC. Because he was an insider, the *in pari delicto* doctrine does not apply to bar the Trustee's equitable claims.

F. The Court Should Grant the Trustee Leave to Amend

If the Court determines that the Trustee has failed to state a claim with respect to any of his causes of action, the Trustee requests leave to amend the Complaint to cure any deficiency.

CONCLUSION

For the reasons expressed herein, the Court should deny Austin's Motion and permit all of the Trustee's claims to go forward in this Court.

DATED this 20th day of February, 2015.

DORSEY & WHITNEY LLP

/s/ Milo Steven Marsden
Milo Steven Marsden
Peggy Hunt
Sarah Goldberg
Attorneys for D. Ray Strong, Liquidating Trustee

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[22] *See Mosier v. Callister, Nebeker & McCullough*, 546 F.3d 1271, 1276 (10th Cir. 2008) (involving a suit against an outside law firm and explaining that "it is well settled that *in pari delicto* may bar an action by a bankruptcy trustee against third parties who participated in or facilitated wrongful conduct of the debtor" (underline added)) and *Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Inv. Secs., LLC)*, 721 F.3d 54, 58 (2d Cir. 2013) (involving claims against third party outside accounting firms).

CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of February, 2015, I caused a true and correct copy of the foregoing **RESPONSE TO MOTION OF DEFENDANTS JEFF AUSTIN AND AUSTIN CAPITAL SOLUTIONS TO COMPEL ARBITRATION AND/OR DISMISS** to be filed with the United States District Court for the District of Utah by using the CM/ECF system, which will automatically send email notifications of such filing to all counsel who have entered an appearance in this action.

/s/ Sarah Goldberg