IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

D. RAY STRONG, Plaintiff, vs. KIRBY D. COCHRAN, et al., Defendants.	ORDER Case No. 2:14-cv-00788-TC

Plaintiff D. Ray Strong was appointed by the United States Bankruptcy Court for the District of Utah to act as the post-confirmation estate representative of several entities, including Castle Arch Real Estate Investment Company, LLC; CAOP Managers, LLC; Castle Arch Kingman, LLC; Castle Arch Smyrna, LLC; Castle Arch Secured Development Fund, LLC; Castle Arch Star Valley, LLC; Castle Arch Opportunity Partners I, LLC; and Castle Arch Opportunity Partners II, LLC (collectively, "the Debtors"). The bankruptcy court also appointed Mr. Strong as liquidating trustee of Consolidated Legacy Debtors Liquidating Trust; Castle Arch Opportunity Partners I, LLC Liquidating Trust; and Castle Arch Opportunity Partners II, LLC Liquidating Trust (collectively, "the Trusts"). Mr. Strong filed this suit on behalf of the Debtors and the Trusts. The complaint alleges that Defendants Kirby Cochran, Jeff Austin, and Douglas Child formed Castle Arch Real Estate Investment Company, LLC (CAREIC) and the other Debtors to develop various real estate projects. As officers and directors of the Debtors, Defendants allegedly engaged in misconduct that led to the loss of investors' funds.

In lieu of an answer, Defendants Jeff Austin and Austin Capital Solutions[1] filed a Motion to Compel Arbitration Pursuant to 9 U.S.C. § 4 and Utah Code § 78B-11-108; Stay the Case Pursuant to 9 U.S.C. § 3 and Utah Code § 78B-11-108; and/or Dismiss the Claims Pursuant to Federal Rule of Civil Procedure 12(b)(6) (Dkt. No. 12). After careful review of the pleadings, the relevant materials filed by the parties, and the applicable law, the court grants the motion to the extent Mr. Austin seeks to compel arbitration of the first and eighth claims in the complaint, although arbitration of the eighth claim will be stayed. The court takes the motion under advisement for the remaining claims (Claims 2-7 and 9-19) until the parties conduct discovery on the issue of whether investors entered into a subscription agreement that incorporated CAREIC's Amended Operating Agreement and its arbitration clause. All other proceedings in this case will be stayed while the parties proceed with limited discovery on the arbitration issues. The court will not rule on the motion to dismiss until the arbitration issues are resolved.

BACKGROUND

According to the complaint and materials publicly filed with the Securities and Exchange Commission (SEC),[2] the individual Defendants served as officers and directors of the Debtors.

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[1] "Austin Capital Solutions is a California entity that is solely owned and managed by [Mr.] Austin and which received transfers of cash from the Debtors." (Compl. ¶ 23, Dkt. No. 2.) Throughout this decision the court will refer to Mr. Austin and Austin Capital Solutions collectively as "Mr. Austin," except where it is necessary to distinguish between the two.

[2] The facts are taken primarily from the complaint, with "all well-pleaded factual allegations . . . accepted as true and viewed in the light most favorable to [Mr. Strong]." Sutton v. Utah State Sch. for the Deaf & Blind, 173 F.3d 1226, 1236 (10th Cir. 1999). To further support his motion, Mr. Austin provided additional documents, including documents that were publicly filed with the SEC. The Tenth Circuit has not decided whether a district court may take judicial notice of SEC materials, but other courts have held "that a court, when considering a motion to dismiss in a securities fraud case, may take judicial notice (for the purpose of determining what statements the documents contain and not to prove the truth of the documents'

Mr. Cochran served as CAREIC's CEO from its inception until he resigned in November 2010. Mr. Child was CAREIC's CFO. Mr. Austin was CAREIC's Senior Vice President of Business Development[3] until he took over as CEO when Mr. Cochran resigned in November 2010. All three men were members of CAREIC's Board of Directors. The other Defendants, including individuals and entities, were involved in CAREIC's management.

"[D]uring CAREIC's existence, CAREIC Management formed several other entities . . . claiming that these entities were created to develop specific projects or to exploit specific investment opportunities" and "raised approximately $73 million from investors to fund the operations of CAREIC or one of its special purpose entities." (Compl. ¶¶ 33-34, Dkt. No. 2.)

On February 16, 2007, the members of CAREIC signed an Amended Operating Agreement, which includes the following paragraph:

> 15.16 Disputes. Any dispute or other disagreement arising from or out of this Amended Operating Agreement or the performance of any officer, director or agent on behalf of the company shall be submitted to arbitration under the rules of the American Arbitration Association. . . .

(Am. Operating Agreement at 35, Dkt. No. 13-1.)

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contents) of relevant public documents required to be filed with the SEC, and actually filed." Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1278 (11th Cir. 1999). Mr. Strong does not dispute that the court may take judicial notice of the documents. So the court has considered the SEC documents for the limited purpose of determining whether the documents contain an arbitration agreement. Because this is a motion to dismiss, the court has not considered any other documents submitted by the parties that provide material outside the complaint.

[3] CAREIC's private placement memorandum (PPM) identifies Mr. Austin as "Director and President of Worldwide Business Development." (PPM at 25, Dkt. No. 13-1.) Because the difference in titles does not affect any of the issues raised in this motion, the court will use Mr. Austin's title that was pled in the complaint.

In the complaint, Mr. Strong alleges that the Defendants, including Mr. Austin, mismanaged the Debtors and otherwise acted in ways that resulted in the loss of millions of dollars invested in the Debtors. Based on the Defendants' alleged misconduct, Mr. Strong asserts nineteen claims in his complaint: (1) breach of fiduciary duty; (2) violation of Utah, Nevada, and California state securities laws; (3) securities fraud under Section 10(b) and Rule 10b-5; (4) control person liability; (5) common law fraud; (6) negligent misrepresentation; (7) civil conspiracy; (8) violation of state RICO laws, including Utah Code Ann. § 76-10-1605; (9) avoidance of fraudulent transfers under 11 U.S.C. § 548(a)(1)(A); (10) avoidance of fraudulent transfers under 11 U.S.C. § 548(a)(1)(B); (11) avoidance of fraudulent transfers under 11 U.S.C. § 544(b) and Utah Code Ann. §§ 25-6-5(1)(a) and 25-6-8; (12) avoidance of fraudulent transfers under 11 U.S.C. § 544(b) and Utah Code Ann. §§ 25-6-5(1)(b) and 25-6-8; (13) avoidance of fraudulent transfers under 11 U.S.C. § 544(b) and Utah Code Ann. §§ 25-6-6(1) and 25-6-8; (14) avoidance of fraudulent transfers under 11 U.S.C. § 547(b); (15) recovery of avoided transfer under 11 U.S.C. §§ 550 and 551; (16) disallowance of claims; (17) subordination; (18) constructive trust; and (19) unjust enrichment and disgorgement.

ANALYSIS

Mr. Austin seeks two orders from the court. First, relying on the arbitration clause in the Amended Operating Agreement, Mr. Austin asks the court to compel arbitration of all claims in the complaint. Second, Mr. Austin moves to dismiss all claims for failure to state a claim. For the reasons explained below, the court grants the motion to compel arbitration in part and takes the remainder under advisement. The court will also take the motion to dismiss under advisement until the arbitration issues are resolved.

I. Motion to Compel Arbitration

In opposing Mr. Austin's motion to compel arbitration, Mr. Strong contends that Mr. Austin should be treated as a creditor who cannot invoke the arbitration clause. Alternatively, Mr. Strong argues that the Debtors' investors did not agree to arbitration and, moreover, several of the claims are statutory causes of action that are not subject to arbitration.

A. Creditor Provision of the Amended Operating Agreement

Paragraph 15.14 of the Amended Operating Agreement reads: "None of the provisions of this Agreement shall be for the benefit of or enforceable by any creditors of the Company." (Dkt. No. 13-1.) In the underlying bankruptcy case, Mr. Austin filed a proof of claim against the Debtors for unpaid compensation. Although Mr. Strong does not concede that Mr. Austin has a valid creditor claim,[4] Mr. Strong argues that by filing the proof of claim, Mr. Austin identified himself as a creditor of the Debtors, and as such, he may not benefit from any provision of the Amended Operating Agreement, including the arbitration clause.

The court agrees with the general principle that a party "may not attempt to use one section of the CAREIC Operating Agreement for his benefit while ignoring the sections that are detrimental to him." (Resp. to Mot. of Defs. Jeff Austin and Austin Capital Solutions to Compel Arbitration and/or Dismiss at 1, Dkt. No. 21.) Indeed, under California law,[5] a "contract must be construed as a whole and the intention of the parties must be ascertained from the consideration

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[4] The complaint in fact alleges that Mr. Austin's claim has not been confirmed and may still be challenged. (Compl. ¶ 258, Dkt. No. 2.)

[5] The Amended Operating Agreement "and its application and interpretation shall be governed exclusively by its terms and by the law of the State of California." (Am. Operating Agreement at p. 33, ¶ 15.3, Dkt. No. 13-1.)

of the entire contract, not some isolated portion." County of Marin v. Assessment Appeals Bd., 134 Cal. Rptr. 349, 352 (Cal. Ct. App. 1976).

But where a contract includes an arbitration clause, "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration." Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). In addition, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." Id. at 24-25.

The parties to the Amended Operating Agreement, including Mr. Austin, specifically agreed to arbitrate "[a]ny dispute or other disagreement arising from or out of this Amended Operating Agreement or the performance of any officer, director or agent on behalf the Company." (Am. Operating Agreement at p. 35, ¶ 15.16, Dkt. No. 13-1.) With such a broad arbitration clause, see Newmont U.S.A., Ltd. v. Ins. Co. of N. Am., 615 F.3d 1268, 1274-75 (10th Cir. 2010) (language requiring arbitration of any dispute "arising out of" the agreement was a broad arbitration clause), the presumption of arbitrability is "particularly applicable." AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 650 (1986).

Although the Amended Operating Agreement does not allow creditors to benefit from or enforce the agreement, the word "creditor" is not defined. Each member of CAREIC at some point could have become a creditor if the company failed to pay salary or other compensation. That does not mean that the parties intended to forfeit their rights to enforce their contract. Moreover, as alleged in the complaint, Mr. Austin's proof of claim has not been allowed and is still subject to Mr. Strong's objections. In light of the strong presumption in favor of arbitration,

the court concludes that, as a signatory to the Amended Operating Agreement, Mr. Austin may invoke the agreement's arbitration clause.

The next question is which claims are subject to arbitration. The court first addresses the claims that it finds are arbitrable and then addresses the remaining claims, which require discovery before the court can make a decision on arbitrability.

B. Breach of Fiduciary Duty (Claim 1)

Mr. Strong's first claim is for breach of fiduciary duty. This claim relates to Mr. Austin's performance as an officer and director of CAREIC, which falls squarely within the scope of the arbitration clause. Moreover, Mr. Strong asserts this claim on behalf of the Debtors, who agreed to the Amended Operating Agreement, including the arbitration provision.

The breach of fiduciary claim must be arbitrated.

C. Utah RICO Claim (Claim 8)

Mr. Strong's eighth claim alleges violations of the Utah RICO statute, Utah Code. Ann. § 76-10-1605. Subsection (3) of this statute mandates that "[a]ll actions arising under this section which are grounded in fraud are subject to arbitration under Title 78B, Chapter 11, Utah Uniform Arbitration Act." Because Mr. Strong repeatedly alleges fraudulent conduct in his RICO claim, (see Compl. ¶¶ 371-79), the claim must be arbitrated.

To answer the question of whether the arbitration of the Utah RICO claim may be stayed, the court applies the Utah Arbitration Act, which reads: "[i]f a court orders arbitration, the court on just terms shall stay any judicial proceeding that involves a claim subject to the arbitration." Utah Code Ann. § 78B-11-108(7). But "[i]f a claim subject to arbitration is severable, the court may limit the stay to that claim." Id.

Under this statute, if an arbitrable claim is severable, the court may sever the claim and stay the proceedings for that claim. Mr. Strong's breach of fiduciary duty claim is subject to arbitration and, as explained below, Claims 2-7 and 9-19 may be subject to arbitration. Because the arbitration of the RICO claim will be repetitive of the arbitration and/or litigation of Mr. Strong's other claims, the court will sever the Utah RICO claim and stay the arbitration of that claim until the other claims are resolved.

D. Investors' Claims (Claims 2-7)

Claims 2-7 are asserted on behalf of certain creditors—namely, the Debtors' investors. Although the court recognizes the general presumption favoring arbitration, "this presumption disappears when the parties dispute the existence of a valid arbitration agreement," Dumais v. Am. Golf Corp., 299 F.3d 1216, 1219-20 (10th Cir. 2002), because "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." AT&T Techs., 475 U.S. at 648.

Here, it is not clear that any investor agreed to arbitration. Mr. Austin contends that certain investors agreed to the CAREIC Subscription Agreement, which includes this provision:

> The purchase of Investment Units is subject to the terms and conditions set forth in the Memorandum and in [CAREIC's] Amended Operating Agreement dated February 16, 2007 (the 'Operating Agreement'), by and among the members of the Company. The Operating Agreement is incorporated herein by this reference.

(Subscription Agreement at 1, Dkt. No. 13-1.) With its incorporation of the Amended Operating Agreement, the Subscription Agreement could provide grounds for compelling arbitration of the investors' claims. But at this stage, the court cannot determine whether investors signed the Subscription Agreement and, if they did, whether they understood that the Amended Operating

Agreement included an arbitration clause. Nothing in the complaint or SEC filings shows that the investors agreed to arbitration. Mr. Austin has not produced signed copies of the Subscription Agreement or any other evidence to demonstrate that investors agreed to the arbitration clause. Without such evidence, the court cannot force the investors to arbitrate their claims. Accordingly, the court takes the motion under advisement for Claims 2-7. If discovery shows that certain investors agreed to arbitration, Mr. Austin may renew his motion to arbitrate those claims.

E. Statutory Claims (Claims 9-19)

The same conclusion applies to Claims 9-19, which are claims of fraudulent and preferential transfers, disallowance of claims, subordination, and other claims, all of which are based on the Bankruptcy Code. "These 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." Allegaert v. Perot, 548 F.2d 432, 436 (2d Cir. 1977). Because statutory claims "are not derivative of the bankrupt" and because "it is the *parties* to an arbitration agreement who are bound by it," courts have generally found that "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." Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149, 1155 (3d Cir. 1989). But this is not a case where it is clear that the trustee is bringing the claims on behalf of creditors who did not agree to arbitration.

Here, at least some of the Debtors' creditors (the investors) may have agreed to arbitration. Because the trustee stands in the shoes of the creditors, including investors, for purposes of his statutory claims, the trustee is bound by any arbitration agreements made by the

investors. Although Mr. Strong may represent other creditors who were not investors in the Debtors, the court does not have enough information to distinguish between creditors who may have agreed to arbitration and those who did not. As a result, the court takes this issue under advisement until discovery is complete on the issue of which investors agreed to arbitration.

ORDER

For the foregoing reasons, Mr. Austin's motion (Dkt. No. 12) is GRANTED IN PART. The motion is granted to the extent that Mr. Austin seeks to compel arbitration for Claim 1 and Claim 8 in the complaint, although arbitration for Claim 8 will be stayed. For Claims 2-7 and 9-19, the court takes the motion under advisement until Mr. Austin files a renewed motion with evidence to support the conclusion that the Debtors' investors agreed to arbitrate their claims.

The parties are ordered to conduct limited discovery on the issue of who knowingly agreed to arbitration by signing the CAREIC Subscription Agreement. The parties must complete this discovery by Friday, July 3, 2015. After discovery is complete, Mr. Austin may file a renewed motion to compel arbitration limited to the issue of which investors agreed to arbitration. Mr. Austin's renewed motion is due by Friday, July 17, 2015. All other proceedings in this case will be stayed while the parties proceed with discovery.

The court will not rule on the motion to dismiss until the arbitration issues are resolved.

DATED this 4th day of May, 2015.

BY THE COURT:

Tena Campbell

TENA CAMPBELL
U.S. District Court Judge