In the Third Judicial District Court, Salt Lake County, State of Utah

R. WAYNE KLEIN, as Court-Appointed Receiver for FFCF INVESTORS, LLC, ASCENDUS CAPITAL MANAGEMENT, LLC, and SMITH HOLDINGS, LLC, **Plaintiffs,** **vs.** **PENSON FINANCIAL SERVICES, INC., and CONSILIUM TRADING COMPANY, LLC** **Defendants.**	**MEMORANDUM DECISION** Case No. 100924572 Hon. Deno G. Himonas

Before the Court is Defendant Penson Financial Service, Inc.'s (Penson) Motion to Dismiss the Amended Complaint filed by R. Wayne Klein (the Receiver) as the court-appointed receiver for FFCF Investors, LLC, Ascendus Capital Management, LLC, and Smith Holdings, LLC (collectively, the Receivership Entities). For the reasons discussed in this Memorandum Decision, I DENY the motion.[1]

BACKGROUND[2]

The Amended Complaint alleges that Roger E. Taylor and Richard T. Smith formed the Receivership Entities as part of a ponzi scheme to fraudulently obtain money from investors. Taylor and Smith, as principals of the Receivership Entities, solicited several million dollars from investors and deposited that money into various accounts with Penson and the Receivership Entities. Taylor and Smith were authorized to use those funds to make trades and purchases in order to obtain a profit on the investors' accounts.

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[1] I also deny Penson's oral request to convert the motion to dismiss into a motion for summary judgment. I do not believe I have relied on any materials other than those included with the Amended Complaint in analyzing the motion to dismiss, and therefore, it is unnecessary to convert the motion to dismiss into a motion for summary judgment. *See generally* Utah R. Civ. P. 12(b)-(c) (stating that if matters outside of the pleadings are not excluded, a motion to dismiss "shall be treated as one for summary judgment").

[2] Because this matter is before the Court on a motion to dismiss, I accept the allegations in the Amended Complaint as true and view the inferences drawn therefrom in the light most favorable to the Receiver. *See Peterson v. Delta Air Lines, Inc.*, 2002 UT App 56, ¶ 2, 42 P.3d 1253 (stating that a court evaluating a motion to dismiss "must accept the factual allegations in the complaint as true and consider all reasonable inferences to be drawn from those facts in a light most favorable to the plaintiff" (internal quotation marks omitted)); *see also Jones v. Barlow*, 2007 UT 20, 154 P.3d 808, 811 *v. Div. of Water Rights of Dept. of Natural Res.*, 2010 UT 14, ¶ 15, 228 P.3d 747 ("[A]lthough a challenge to standing is jurisdictional and may be brought at any stage of the litigation, such a challenge is to be evaluated under the standard used for a dispositive motion at the relevant stage of litigation.").

After withdrawing a portion of the funds for commissions, Taylor and Smith (acting through Penson) improperly transferred funds between Penson, the Receivership Entities, and accounts that Taylor and Smith controlled. Taylor and Smith allegedly made these transfers and provided the investors with falsified account statements in order to give the investors the false sense that they were profiting from the transfers when, in reality, most of the investors were losing significant amounts of money each month. These transfers occurred in violation of the terms of an agreement that Penson had entered into with its investors.

As a consequence of Taylor's and Smith's actions, including the improper transfers to Penson, the Receivership Entities became liable to the investors for the losses. The Amended Complaint further alleges that the Receivership Entities were also damaged by the transfers in question because funds were taken out of the accounts without the then-insolvent Receivership Entities receiving anything of value in return.

Taylor and Smith eventually sought to close down several of the Receivership Entities, and upon the discovery of their allegedly fraudulent actions, Taylor and Smith were removed from their positions with the Receivership Entities. The Receiver was subsequently appointed and given authorization to manage and "investigate the affairs of the Receivership Entities, marshal and safeguard their assets, . . . to institute legal proceedings for the benefit of the Receivership Entities and their investors and creditors." (Am. Compl. ¶ 2.) The Receiver also received express authorization to investigate the conduct of Penson and assert any necessary actions against Penson on behalf of the Receivership Entities.[3] Pursuant to that authority, the Receiver filed this action against Penson. Three of the Receiver's claims remain pending before this Court.[4] Penson now seeks the dismissal of those claims.

ANALYSIS

Penson seeks the dismissal of the Amended Complaint on three grounds: (1) The Receiver lacks standing to assert the claims in question; (2) the Receiver's claims are barred by the *in pari delicto* doctrine; and (3) the Receiver's fraudulent transfer claims are barred by either the Utah Uniform Fraudulent Transfer Act (UFTA), *see* Utah Code Ann. § 25-6-5 (2011), or the statute of limitations.[5] I address each of these arguments in turn. Because standing is a threshold issue, our appellate courts have instructed that a party's standing to assert a claim should normally be addressed before reaching the other issues. *See Jones v. Barlow*, 2007 UT 20, ¶ 12, 154 P.3d 808 ("[S]tanding is a jurisdictional requirement that must be satisfied before a court may entertain a controversy between two parties." (internal quotation marks omitted)). I therefore begin my analysis by addressing Penson's argument that the Receiver lacks standing. I

[3] The Receiver and the investors have brought separate actions against Taylor, Smith, and others. Several investors also assigned their individual claims against Penson to the Receiver. Per the parties' stipulation, those claims were stayed in this Court, based on an arbitration provision in the agreements that the investors and Penson entered into.

[4] The Amended Complaint also asserts those claims against Consilium Trading Company, LLC, which is not a party to the motion to dismiss.

[5] Initially, Penson also sought the dismissal of the claims for aiding and abetting a breach of fiduciary duty and aiding and abetting fraud on the ground that Utah does not recognize those causes of action. However, Penson subsequently withdrew that argument based on a recent decision by the Utah Court of Appeals that expressly recognized these causes of action. *See Mower v. Simpson*, 2012 UT App 149, ¶¶ 37-38, 708 Utah Adv. Rep. 12.

then turn to Penson's assertion that the *in pari delicto* bars the Receiver's claims. Finally, I address Penson's argument that the claims either are time-barred or are barred the UFTA.

I. The Receiver Has Standing to Bring the Claims.

Turning first to the standing issue, Penson argues that the Receiver lacks standing to assert the claims on behalf of the Receivership Entities because the Amended Complaint only alleges injuries to the individuals and does not allege any injury to the Receivership Entities.[6] *See generally Brown v. Division of Water Rights of Dept. of Natural Res.*, 2010 UT 14, ¶¶ 17-18, 228 P.3d 747 (stating that to establish standing, a plaintiff must show that they have been or will be injured by the defendant's actions); *Jenkins v. Swan*, 675 P.2d 1145, 1150 (Utah 1983) ("One who is not adversely affected [by the actions in question] has no standing."). I disagree.

As the Receiver states, the Amended Complaint includes several allegations of injury to the Receivership Entities. The primary injury alleged in the Amended Complaint is that the Receivership Entities were injured because Taylor's and Smith's fraudulent actions, in which Penson took an active part, "caused [the Receivership Entities] to owe money to each of their investors who lost money in the fraudulent schemes," and as a result, "[e]ach underpaid investor became a tort creditor to" the Receivership Entities.[7] (Mem. Opp. Mot. Dismiss 2.) As the Receiver notes, decisions from other jurisdictions have recognized that a plaintiff may have standing under such a tort-creditor theory. *See Donnell v. Kowell*, 533 F.3d 762, 777 (9th Cir. 2008); *Scholes v. Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995); *Hays v. Adam*, 512 F. Supp. 2d 1330, 1340-41 (N.D. Ga. 2007). However, Penson argues that those cases are inapplicable because, under Utah law, such a tort-creditor theory is insufficient to show that the Receivership Entities sustained the type of injury that establishes their standing.

In support of its position, Penson cites to *Coroles v. Sabey*, 2003 UT App 339, 79 P.3d 974, where the Utah Court of Appeals rejected a damages claim based solely on an allegation the defendants' actions caused "deepening insolvency" to a corporation. *See id.* ¶ 33. In *Coroles*, the plaintiffs argued that a corporation was harmed where defendants allegedly used investors' money to pay the corporation's attorney fees, "buy out" other investors, and pay several "unpaid creditors," rather than returning the money to the plaintiffs. *See id.* The court of appeals held that the plaintiffs had not plead any damages, reasoning that although some of the individual investors may have been harmed by those actions, the corporation that was "the supposed victim" of defendants' actions was not actually "harmed by having its past-due bills and other listed expenses paid." *Id.*

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[6] Penson does not argue that the Receiver lacks standing on redressability or causation grounds. *See generally Brown v. Division of Water Rights of Dept. of Natural Res.*, 2010 UT 14, ¶ 17, 228 P.3d 747 (noting that Utah's traditional standing test consists of "three basic elements—injury, causation, and redressability"). Accordingly, I limit my analysis of the standing issue to the question of whether the Receiver has sufficiently plead an injury.

[7] The Receiver also points out that the Amended Complaint alleges that Taylor's and Smith's actions constituted a breach of the fiduciary duties that they owed to the Receivership Entities. In light of the fact that the Amended Complaint alleges that Penson aided and abetted that breach, it would seem that such a breach of fiduciary duties would be sufficient to constitute an injury under Utah's standing jurisprudence. However, because briefing on this issue is minimal, I do not address that issue in-depth.

Based on those facts, *Coroles* is clearly distinguishable from the case at bar. Unlike in *Coroles*, where the funds were used to pay the corporation's bills, there is nothing before me to indicate that Taylor and Smith, aided by Penson, used any of the funds in question to benefit the Receivership Entities. To the contrary, as noted above, the Amended Complaint alleges that Penson fraudulently transferred funds away from the Receivership Entities and the Receivership Entities received nothing in return for those transfers. Furthermore, as a result of those transfers, the Receivership Entities allegedly became liable to the investors where no liability would have otherwise existed.[8] Consequently, the Receivership Entities were clearly injured both because money was diverted away from the Receivership Entities and because those transfers caused the Receivership Entities to become liable to the investors.[9] *See Knauer v. Jonathon Roberts Fin. Group, Inc.*, 348 F.3d 230, 234 (7th Cir. 2003) (distinguishing between fraudulent activities that benefit a corporation, for which no standing would exist, and activities that divert money away from a corporation, for which standing would exist). Therefore, the Receiver has standing to pursue these actions against Penson.

II. The In Pari Delicto Doctrine Does Not Apply.

Next, Penson claims that the Receiver's claims are barred based on the *in pari delicto* doctrine, which precludes a plaintiff from recovering from another party to an illegal transaction where the plaintiff is equally or more at fault in the transaction. *See Haddock v. Salt Lake City*, 23 Utah 521, 65 P. 491, 492 (1901); *State v. Garcia*, 866 P.2d 5, 7 (Utah Ct. App. 1993). Thus, Penson argues, because the Receivership Entities participated in the fraudulent activities, they cannot now seek to recover from Penson. The Receiver disagrees, arguing that the *in pari delicto* doctrine does not apply in a case such as this, where the wrongdoers are removed from the corporation.

Utah's case law on the *in pari delicto* doctrine is sparse, having been applied only occasionally over the last century. However, a majority of the courts in other jurisdictions that have considered the issue have adopted a rule similar to the one suggested by the Receiver in this case. The principal case on this issue is *Scholes*. There, the court was asked to determine whether the *in pari delicto* doctrine would prevent a receiver from maintaining a fraudulent conveyance action on behalf of several corporations that were used by an individual to perpetrate a ponzi scheme on behalf of several investors. *See Scholes*, 56 F.3d at 752-53. The court answered that question in the negative, reasoning that with the appointment of the receiver, the corporations were no longer culpable because the individual wrongdoer who was at fault had been removed. *See id.* at 754. As the *Scholes* court put it,

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[8] At oral argument, counsel for Penson acknowledged that the Receiver is correct that a tort-creditor theory differs from the deepening insolvency theory that was rejected in *Coroles*.

[9] Thus, even if the amount recovered is identical to the amount that the individual investors are owed, that would not change my conclusion that the Amended Complaint sufficiently alleges an injury to the Receivership Entities. While the individual investors may have claims for damages against both Penson and the Receivership Entities, if the investors' claims against the Receivership Entities are valid and must be paid, the only way the Receivership Entities can recover that money is to pursue an action against those who instigated and participated in the fraudulent activities that caused the Receivership Entities to become liable in the first instance. Consequently, any amount that the Receiver recovers may benefit both the Receivership Entities and the individual investors.

> The corporations, [the wrongdoer]'s robotic tools, were . . . in the eyes of the law separate legal entities with rights and duties. . . . The appointment of the receiver removed the wrongdoer from the scene. The corporations were no more [his] evil zombies. Freed from his spell they became entitled to the return of the moneys—for the benefit not of [the wrongdoer] but of innocent investors—that [the wrongdoer] had made the corporations divert to unauthorized purposes. . . . Put differently, the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated.

Id.

Penson notes that several courts have limited *Scholes* to the fraudulent conveyance context. However, as the Receiver points out, almost all of the courts that have limited *Scholes* to fraudulent conveyance claims have done so in the context of a bankruptcy case, which differs significantly from a receivership case because the Bankruptcy Code requires a trustee to bring an action based on the parties' status at the time the cause of action accrued, while a receiver does not face such a limitation.[10] *See Fine v. Sovereign Bank*, 634 F. Supp. 2d 126, 140 n.19 (D. Mass. 2008). Indeed, at least one court has reviewed the cases and made precisely that distinction. *See id.* Such a distinction appears to be logical and well-founded, and I agree with the reasoning of the Seventh Circuit in *Scholes.* Therefore, I conclude that the *in pari delicto* defense would not bar the claims in this case because the wrongdoers—Taylor and Smith—have been removed from the Receivership Entities.[11]

III. The Fraudulent Transfer Claims are Not Time-Barred or Barred by the UFTA.

Lastly, Penson argues that the Receiver's claims are barred by either the UFTA or the statute of limitations. With respect to the UFTA, Penson argues that it is not subject to the UFTA because it was not a "transferee" under the UFTA, *see* Utah Code Ann. § 25-6-9(2), as that term has been defined by other courts, *see In re Ogden*, 314 F.3d 1190, 1196 (10th Cir.

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[10] Penson cites to *Knauer* as an exception to the rule, arguing that *Knauer* limits the *Scholes* rule to cases involving a fraudulent conveyance claim. *See Knauer v. Jonathon Roberts Fin. Group, Inc.*, 348 F.3d 230, 236 (7th Cir. 2003). I do not read *Knauer* so broadly. In distinguishing *Scholes*, the *Knauer* court noted that *Scholes* was a fraudulent conveyance case, but emphasized that the "key difference" between *Scholes* and *Knauer* was "the identities of the defendants." *Id.* In *Knauer*, the defendants were only minimally involved in the wrongdoing and did not actually benefit from any of the improper diversions of funds, and therefore, the equities weighed against allowing the receiver to pursue a claim against the defendants. *See id.* Indeed, the court went on to state that if the defendants had "been directly involved in the embezzlements, or attained some tangible benefit from them," the *in pari delicto* defense would probably not apply. *Id.* at 237 n.6. Absent such a showing, the court concluded that the "equitable balancing" required by the *in pari delicto* doctrine weighed against allowing the receiver to recover from the largely innocent defendants. *See id.* at 236. Likewise, *Hays v. Pearlman*, 2:10-CV-1135-DCN, 2010 WL 4510956, at *7 (D.S.C. Nov. 2, 2010), and *Myatt v. RHBT Fin. Corp.*, 635 S.E.2d 545, 548 (S.C. Ct. App. 2006), applied *Knauer* to bar claims against defendants who did not benefit from or significantly participate in the allegedly fraudulent activities. Here, in contrast, the Amended Complaint alleges that Penson was actively involved in Taylor's and Smith's wrongdoing and that Penson benefitted from the improper transfer of funds. Therefore, the cases cited by Penson would not bar the Receiver from recovering from Penson on *in pari delicto* grounds.

[11] I also note that because the *in pari delicto* defense involves weighing and comparing the fault of the parties, the defense is particularly fact-intensive, the defense is generally "not an appropriate basis for dismissal" on a rule 12(b) motion to dismiss. *Knauer*, 348 F.3d at 237 n.19.

2002) (distinguishing between transferees and mere financial conduits based on whether the entity "exercise[s] dominion and control over the funds" (internal quotation marks omitted)). Penson's argument fails because the Amended Complaint specifically alleges that Penson exercised dominion and control over the funds and assets in question, including knowingly transferring funds directly out of investors' accounts without proper authorization, sending funds to accounts controlled by Taylor in direct contravention to the agreements between Penson and its investors, improperly transferring funds to and from the Receivership Entities, and fraudulently transferring assets between investors' accounts. Consequently, I reject Penson's argument that the Amended Complaint fails to sufficiently allege that Penson exercised dominion and control over the funds and assets in question.

Penson's argument with respect to the statute of limitations fails for similar reasons.[12] First, as the Receiver states, the UFTA contains a one-year discovery rule.[13] *See* Utah Code Ann. § 25-6-10(1) (allowing a party to bring a fraudulent conveyance action "within one year after the transfer or obligation was or could reasonably have been discovered by the claimant"). There is nothing before the Court to indicate when the fraudulent transfers were "or could reasonably have been discovered" by the Receivership Entities, *id.*, and consequently, I am unable to determine whether the statute of limitations has run. Likewise, the Receiver has raised an adverse domination argument that tolls the statute of limitations while "the entity is controlled or dominated by individuals engaged in conduct that is harmful to the entity. " *Warfield v. Carnie*, 3:04-CV-633-R, 2007 WL 1112591, at *15 (N.D. Tex. Apr. 13, 2007); *see also Farmers & Merchants Nat. Bank v. Bryan*, 902 F.2d 1520, 1522 (10th Cir. 1990) (recognizing that an adverse domination theory equitably tolls the statute of limitations). While Penson is correct that the adverse domination theory does not apply to a third party who exercises no control over another entity, *see Nasr v. De Leon*, 18 Fed. Appx. 601, 604-05 (9th Cir. 2001), the Amended Complaint does allege that Penson exercised at least some control over the Receivership Entities. Indeed, the Amended Complaint alleges that Penson was an active and knowing participant in Taylor's and Smith's actions and even directed that funds be transferred to and from accounts with the Receivership Entities. For these reasons, I also reject Penson's arguments that the statute of limitations bars the Receiver's claims against it.

CONCLUSION

As explained in detail above, the Receiver has standing to bring these claims against Penson because the Amended Complaint alleges injuries to the Receivership Entities. These injuries include the transfer of funds from the Receivership Entities and causing the Receivership Entities to become liable to third parties. Next, because the wrongdoers were removed and the Receiver appointed, the *in pari delicto* doctrine does not preclude the Receiver's claims against Penson. Lastly, the fraudulent transfer claims are not barred by the UFTA or the statute of

[12] In its briefs, Penson also argues that the applicable statute of limitations is actually a statute of repose. However, at oral argument, Penson conceded that the Receiver had the better argument, and that the statute is properly characterized as a statute of limitations.

[13] Penson may be correct that the UFTA's discovery rule does not apply to constructive fraudulent transfers asserted under Utah Code section 25-6-5(1)(b). *Compare* Utah Code Ann. § 25-6-10(1) (2011), *with id.* § 25-6-10(2). However, the Amended Complaint appears to assert claims under section 25-6-5(1)(a) and 25-6-5(1)(b). Moreover, as discussed below, even if the discovery rule does not apply to the Receiver's claims, the adverse domination theory may toll the statute of limitations.

limitations because the Amended Complaint alleges that Penson exercised dominion and control over the funds and assets, that Penson exercised some control over the Receivership Entities, and because there is nothing in the Amended Complaint or the record before the Court to indicate when the Receivership Entities knew or should have known of the fraudulent transfers in question. For these reasons, Penson's motion to dismiss is DENIED.

DATED this 12 day of June, 2012

THIRD DISTRICT COURT

Deno G. Himonas
District Court Judge

CERTIFICATE OF NOTIFICATION

I certify that a copy of the attached document was sent to the following people for case 100924572 by the method and on the date specified.

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/s/ KRISTENE LATERZA

Deputy Court Clerk