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IN THE UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

UNITED STATES OF AMERICA, Plaintiffs, v. JAMES LESLIE READING, CLARE L. READING, FOX GROUP TRUST, MIDFIRST BANK, CHASE, FINANCIAL LEGAL SERVICES, STATE OF ARIZONA Defendants.	Civ. No. 11-0698-PHX-FJM **UNITED STATES' OPPOSITION TO THE MOTION TO DISMISS THE SEVENTH CLAIM IN THE COMPLAINT FILED BY DEFENDANTS' JAMES AND CLARE READING AND THE FOX GROUP TRUST**

I.

STATEMENT

On May 9, 2012, defendants James and Clare Reading ("the Readings") and the Fox Group Trust ("the Trust") moved to dismiss the Seventh Claim in the complaint filed herein on April 8, 2011. In the Seventh Claim, the United States asserted that the alleged transfer of the Readings' residence on June 10, 2005 to the Fox Group Trust was a fraudulent conveyance under the Arizona Uniform Fraudulent Transfer Act, A.R.S. § 44-1001, *et seq.*, and thus has no effect as to the United States' federal tax liens. The Readings and the Trust argue that the claim is barred under A.R.S. §

44-1009 since the complaint was not filed within four years of the June 10, 2005 alleged transfer of the residence. The Readings and the Trust also argue that A.R.S. § 44-1009 is a statute of repose under which the subject claim was "extinguished by four years passage of time" and it is not a statute of limitations.

II.

THE MOTION TO DISMISS SHOULD BE DENIED

The well established principle that the United States is not bound by state statutes of limitation originates from the Supreme Court's decision in *United States v. Summerlin*, 310 U.S. 414 (1940). In *Summerlin*, the Supreme Court specifically held that "when the United States becomes entitled to a claim, acting in its governmental capacity, and asserts its claim in that right, it cannot be deemed to have abdicated its governmental authority so as to become subject to a state statute putting a time limit upon enforcement." *Summerlin*, 310 U.S. at 417. This holding has been reaffirmed on numerous occasions, including by the United States Court of Appeals for the Ninth Circuit. *See Bresson v. Commissioner*, 213 F.3d 1173, 1178-79 (9th Cir. 2000).

26 U.S.C. § 6502(a)(1) provides that "where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun within 10 years after the assessment of the tax." As the action here was filed on April 8, 2011, within ten years from the earliest made assessments at issue in the complaint,[1] the United States' fraudulent conveyance claim is timely.

The argument that the Readings and the Trust are making, that a fraudulent conveyance claim asserted by the United States was extinguished by a state fraudulent transfer "extinguishment" provision, was rejected by the United States Court of Appeals for the Ninth Circuit in *Bresson v. Commissioner*, 213 F.3d at 1177-79. In that case, the Ninth Circuit was faced with an argument that the "claim extinguishment" provision of the California Uniform Fraudulent Transfer Act - which is

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[1] The earliest assessments at issue in the complaint were made on April 23, 2001. *See* the complaint, at ¶¶ 15 and 19.

similar for all intents and purposes to A.R.S. § 44-1009 - prevented the United States from collecting taxes from a transferee more than four years after the transfer took place. *Id.* The Ninth Circuit unequivocally rejected this claim, specifically holding that, although it was proceeding under state fraudulent conveyance law, "the government's underlying right to collect money in this case clearly derives from the operation of federal law (i.e., the Internal Revenue Code), . . .[and that] in its efforts to collect taxes, the United States unquestionably is acting in its sovereign capacity." *Id.* at 1178. Noting that "the right to collect taxes is among the most basic attributes of sovereignty," the Ninth Circuit found that the four year "claims extinguishment" provisions of California's statute were subject to the rule of *Summerlin*, and did not bar the United States from pursing tax collection against the transferee. *Id.*

The United States Court of Appeals for the Fifth Circuit, while considering a similar Texas extinguishment clause in the context of a federal tax case, cited *Bresson* and also rejected the argument that the Readings and the Trust are now making. *See United States v. Evans et al.*, 513 F.Supp.2d 825, 837-38 (W.D.Tex 2007), *aff'd*, 2009 WL 2514156 *2 (5th Cir. 2009). In an non-published opinion, the United States Court of Appeals for the Tenth Circuit also rejected the subject argument while considering a similar New Mexico statute in a federal tax context. *United States v. Spence et al.*, 2001 WL 1715216 *3 (10th Cir. 2000).

For some unknown reason, the Readings and the Trust fail to discuss or consider the Ninth Circuit's *Bresson* case in their moving papers even though it is clearly on-point. Instead they rely on *Warfield v. Alaniz*, 569 F.3d 1015 (D. Ariz. 2006). *Warfield* is not applicable to the instant case. First, it was not a tax case and the 10 year statute of limitations under 26 U.S.C. § 6502 was not at issue. Second, the United States was not a party to that case. Instead, the party that was arguing that it was within the applicable statute of limitations was a court-appointed receiver for a foundation. *Id.*, at 1121 and 1129.

It should be noted that there is some indication that the District Court in *Warfield* may have treated the receiver in question as a quasi-Governmental entity while considering the statute of limitation arguments because the action was "ancillary to an action initiated by the S.E.C." *Id.*, at

1131. However, the receiver - who was represented by private counsel - apparently never raised the Ninth Circuit's *Bresson* case in response to the defendants' extinguishment argument and it appears that *Bresson* was not addressed by the District Court in its opinion. *See* Exhibit A attached hereto (copy of a brief filed by the receiver in 03-cv-2390 as docket number 485, at 23-27[2]).

The United States submits that the controlling court case for purpose of deciding whether A.R.S. § 44-1009 extinguished the fraudulent conveyance claim raised in the instant case is the Ninth Circuit's *Bresson* case, where that appellate court interpreted a similar California statute. The *Warfield* case is a District Court case, it was not a tax case and it was not litigated by the United States. Further, *Bresson*, which is on-point, was apparently not addressed in *Warfield*. Similar to the Ninth Circuit's conclusion in *Bresson*, the Court here should hold that A.R.S. § 44-1009 "cannot evade the rule of *Summerlin*." *Bresson, supra.*, 213 F.3d at 1178.

III.

CONCLUSION

The United States' fraudulent conveyance claim is timely and the Court should deny the motion to dismiss filed by the Readings and the Fox Group Trust.

DATED this <u>23rd</u> day of <u>May</u>, 2012.

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By: <u>/s/ Charles M. Duffy</u>
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[2] Exhibit A was printed from the Court's electronic filing system. It should also be noted that the Ninth Circuit reviewed the *Warfield* case in 2009 but it appears that the Arizona extinguishment clause was not an issue on appeal. *See Warfield v. Alaniz*, 569 F.3d 1015 (9th Cir. 2009).

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 23rd day of May, 2012, I served the foregoing through the Court's electronic filing system:

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Government Exhibit
Exhibit A

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IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

Lawrence J. Warfield, Receiver, Plaintiff, v. Michael Alaniz, et al. Defendants.	Cause No. CV 03-2390 PHX JAT RECEIVER'S RESPONSE AND OPPOSITION TO RADA DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

I. Introduction

Pursuant to Rule 56, Fed. R. Civ. P., the Receiver hereby responds to and opposes the Rada Defendants' Motion for Summary Judgment. The Receiver notes that the "Defendants" consist of Defendants Bestgen, Carroll, Crosswell, Davis, Derk, Frazier, Kerher, Lankford, Rada, Richard and Wehrly. This group of Defendants does not include Defendant Bidwell.

The Defendants' motion for summary judgment should be denied in full. And, this Court should grant summary judgment *sua sponte* to the Receiver on counts five (unjust enrichment) and eleven (equitable disgorgement) of his Complaint.

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Memorandum of Points and Authorities

I. Jurisdiction

A. The District Court Has Personal Jurisdiction Over All Defendants.

Defendants Carroll, Derk, Davis, Frazier, Kerher, Lankford, and Richard ("Non-Resident Defendants") urge the Court to grant summary judgment to Defendants because the Court lacks personal jurisdiction over them.[1]

When a defendant moves to dismiss a complaint for lack of personal jurisdiction, the plaintiff bears the burden of demonstrating that jurisdiction is appropriate. *Schwarzengger v. Fred Martin Motor Co.*, 374 F.3d 797, 800 (9th Cir. 2004). Here, while Non-Resident Defendants have not sought to dismiss the Complaint, the same analysis applies.

The Non-Resident Defendants argue that the Plaintiff must satisfy a two part test to establish personal jurisdiction over a defendant. The Non-Resident Defendants argue that Plaintiff must show: (i) has the Defendant done business or caused an event to occur in Arizona out of which the claims arise; and, (ii) is the exercise of personal jurisdiction over the Defendants consistent with the requirements of due process. (*See* Defendants' Motion, 26:16-22). The Non-Resident Defendants' two part test is not the correct analysis for personal jurisdiction. A district court sitting in diversity has personal jurisdiction over a defendant to the extent provided by the law of the forum state. *Data Disc, Inc. v. Sys. Tech Ass'n*, 557 F.2d 1280, 1286 (9th Cir. 1977). Arizona's long arm statute provides for personal jurisdiction within the limits of federal due process Ariz. P. Civ. 4.2(A), *Cohen v. Barnard Volger Co.*, 13 P.3d 758, 760 (Ariz. Ct. App. 2000). Accordingly, this Court should only consider if the exercise of personal jurisdiction over the Defendants comports with due process. *Glencore Grain Rotterdam B.V. v. Shivath Rai Harnarai Co.*, 284 F.3d 1114, 1123 (9th Cir 2003). To satisfy constitutional due process concerns, the non-resident Defendants must have at least "minimum contacts"

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[1] Defendants Rada, Bestgen and Crosswell conceded that this Court has personal jurisdiction over them. Therefore, the Receiver's response will not address these Defendants.

with the forum state and the exercise of jurisdiction must not offend traditional notions of fair play and substantial justice. *Schwarzenegger*, 374 F.3d at 801 (quoting *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945)). Finally, the Court may exercise either general or specific jurisdiction over the Defendants. Here, specific jurisdiction exists against the Non-Resident Defendants.

B. Specific Jurisdiction exists Against the Non-Resident Defendants Carroll, Derk, Davis, Frazier, Kerher, Lankford, and Richard.

A court exercises specific jurisdiction where the cause of action arises out of, or has a substantial connection to, the defendant's contacts with the forum. *Glencoe Grain Rotterdam, B.V.*, *supra*, 284 F.3d at 1123. Here each Rada-Defendant overwhelmingly satisfies each prong of the test for analyzing specific jurisdiction:

> (1) The non-resident defendant must purposefully direct his activities or consummate some transaction with the forum or resident thereof, or perform some act by which he purposefully avails himself of the privilege of conducting activities in the forum thereby invoking the benefit and protections of its laws;
>
> (2) The claim must be one which arises out of or relates to the defendants forum-related activities; and
>
> (3) The exercise of jurisdiction must comport with fair play and substantial justice, i.e., it must be reasonable.

Lake v. Lake, 817 F.2d 1416, 1421 (9th Cir. 1987); *Bancroft & Masters, Inc. v. Augusta Nat'l, Inc.*, 223 F.3d 1082, 1086 (9th Cir. 2000).

C. Purposeful Availment

Plaintiff must establish that a defendant either purposefully availed themselves of the privilege of conducting activities in Arizona or purposefully directed their activities toward Arizona. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). A showing that a defendant purposefully availed himself of the privilege of doing business in a forum state typically consists of evidence of the Defendant's action in the forum, such as executing or performing a contract there. *Schwartzenegger*, 374 F.3d at 802. The

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requirement to establish "purposeful availment" ensures that a defendant will not be hauled into court as the result of random or attenuated contacts. *Burger King Corp.*, 471 U.S. at 475.

It is uncontroverted that MAF, as well as any other Mid-America company detailed herein, was operated in Scottsdale, Arizona. (*See*, RNSOF, 1-3). Here, each Non-Resident Defendant purposely availed themselves of the privilege of selling MAF CGAs. The Rada Defendants entered into contracts with MAF; received commission payments from Arizona based MAF and/or personally visited or regularly communicated with Arizona based MAF to effectuate the sale of Mid America charitable gift annuities issued out of Arizona.

1. Defendant Carroll.

Defendant Robert Carroll signed a "Mid-America Foundation Gift Annuity Agent Compensation Agreement" with Mid-America Foundation on September 23, 1997. (*See,* ROSOF[2], ¶F (1)(a) (ii)). Defendant Carroll executed a second contract, an "Associate Agreement" with Mid America Financial Group ("MAFG"), on June 11, 1996. (*See,* RNSOF 4). Defendant Carroll admitted to the receipt of $83,526.56 in commissions from Arizona. (*See,* ROSOF, ¶F (1)(a)(iv)). Defendant Carroll's activities in Arizona and contracts with MAF establish that Defendant Carroll purposely availed himself of the privilege of conducting activities in Arizona.

2. Defendant Derk

Defendant Derk signed a Mid America Charitable Gift Annuity "General Agent" representation agreement with MAFG. (*See,* ROSOF ¶F (7)(a)(iii)). This "General Agent" contract states it should be enforced under the laws of Arizona. (*See,* Exhibit 33 to ROSOF). Defendant Derk also signed a "Planned Giving Advisor Consultant Agreement" with MAFG in September 2001, wherein, among other things, Defendant Derk consented to the jurisdiction and venue of an appropriate court in Maricopa County,

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[2] The acronym "ROSOF" refers to the Receiver's original Statement of Facts filed with his Motion for Partial Summary Judgment. The acronym "RNSOF" refers to the Receiver's new statement of facts accompanying this response.

Arizona as the proper forum to determine any disputes arising from the contract. (*See,* RNSOF 5). Defendant Derk admitted to the receipt of $44,850.61 in commissions from Arizona. (*See,* ROSOF)¶F (7)(a)(v)). Finally, Defendant Derk attended a two day seminar in Arizona, Mid America University, where he was educated about the MAF Charitable Gift Annuity Program. (*See,* Defendant Derk's Declaration, Exhibit B to *Rada Defendants Separate Statement of Facts)*. Defendant Derk's activities in Arizona and contracts with MAF establish that Defendant Derk purposely availed himself of the privilege of conducting activities in Arizona.

3. Defendant Davis

Defendant Davis signed a "Marketing and Sales" contract with Mid-America in February 1998". (*See* ROSOF ¶F 18(a)(iii)). This contract states it should be governed by Arizona law. Defendant Derk admits to visiting MAF's offices in Arizona on three separate occasions over a three year period. (*See,* Defendant Davis Declaration, Exhibit B to *Rada Defendants' Separate Statement of Facts)*. Defendant Davis admits to the receipt of $198,743.15 in commissions from the sale of MAF CGAs. (*See* ROSOF ¶F 18(a)(vi)). Finally, Defendant Davis testified that, while in Arizona, he negotiated with Mid America to secure exclusive territorial rights to promote Mid America products in the Northeastern United States. (*See,* RNSOF 6). Defendant Davis' activities in Arizona and contracts with MAF establish that Defendant Davis purposely availed himself of the privilege of conducting activities in Arizona.

4. Defendant Frazier

Defendant Frazier admits to the receipt of $40,234.91 in commissions from the sale of three Mid America CGA's. (*See* ROSOF ¶F 12(a)(v)). Defendant Frazier sold MAF CGA's in exchange for a commission payment on all MAF CGA's sold by him. Defendant Frazier admitted he entered into a contract with MAF to sell MAF CGAs as an agent. (*See, Defendants' Separate Statement of Facts*, ¶1). In direct opposition to Mr. Frazier's Declaration, Defendant Kerher, a business partner of Defendant Frazier testified that Defendant Frazier visited MAF in Arizona, twice, to obtain information about MAF.

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(*See,* RNSOF 8). Defendant Frazier's activities in Arizona and contracts with MAF establish that Defendant Frazier purposely availed himself of the privilege of conducting activities in Arizona.

5. Defendant Kerher

Defendant Kerher entered into two separate contracts with Mid-America, a Charitable Gift Annuity "General Agent" agreement and an "Independent Associate Agreement". (*See,* ROSOF ¶F 12(b)(v)). Defendant Kerher testified in detail about his interactions with MAF, including talking to Mid-America employees on the telephone and receiving correspondence from Mid-America by mail. (*See,* RNSOF 9). Defendant Kerher admits to the receipt of $33,038.55 in commission from the sale of Mid America CGA's. (*See* ROSOF ¶F 12(b)(vii)). Defendant's Kerher's activities in Arizona and contacts with the Arizona based MAF satisfy the purposeful availment test.

6. Defendant Lankford

Defendant Lankford entered into three separate contracts with Mid-America; a "Sales and Marketing Agreement" between Mid-America Living Trust Associates and Lankford as President of Mid-America Estate Services; a "Mid-America Foundation Gift Annuity Agent Compensation Agreement"; and a Marketing and Sales Agreement between Mid-America Estate Planning and Defendant Lankford. (*See,* ROSOF ¶F 15(a)(ii)(vii)(x)). Defendant Lankford holds an Arizona Insurance license. (*See* Defendant Lankford Declaration ¶2, Exhibit B to *Rada Defendants' Separate Statement of Facts)*. Defendant Lankford admits to meeting with Robert Dille and other Mid America employees in Arizona during the years of 1998, 1999 and 2000[3]. (*See*

[3] Interestingly, Defendant Lankford in his Declaration states he "never had any discussions with Robert Dillie or any other Mid America representative about the day-to-day operations of Mid America. (*See* Defendant Lankford Declaration ¶5, Exhibit B to *Rada Defendants' Separate Statement of Facts)*. However, Defendant Lankford's deposition is replete with Defendant Lankford's testimony about his conversations with Mid America employees, meetings where Lankford demanding certain financial documents from Mid-America, and discussions of Mid-America internal matters. (*See* RNSOF 10-12). Lankford details meetings with Dillie and Mid America employees. (*See* RNSOF 11). Lankford details conversations with Nelson Happy of Mid-America. (*See* RNSOF 12). Lankford details conversations with Mid America employees and October 2001 financial statement. (*See* RNSOF 10).

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Defendant Lankford Declaration ¶4, Exhibit B to *Rada Defendants' Separate Statement of Facts)*. Defendant Lankford's significant and continuous contacts with Mid-America, including three separate contracts with Mid-America establishes that Defendant Lankford purposely availed himself of the privilege of conducting activities in Arizona.

7. Defendant Richard

Defendant Richard signed a "Mid-America Foundation Gift Annuity Agent Compensation Agreement" in November 1997 wherein Defendant Richard agreed to serve as an agent of the Mid-America Foundation. (*See* ROSOF ¶F 9(c)). Defendant Richard updated his commission agreement with Mid America in 1999 and 2000. (*See* ROSOF ¶F 9(d)). Defendant Richard sold nine Mid America CGA's and received $143,866.94 in commissions. (*See* ROSOF ¶F (f)). Defendant Richard signed a "Planned Giving Advisor Consultant Agreement" with MAFG in July 2000, wherein, among other things, Defendant Richard consented to the jurisdiction and venue of an appropriate court in Maricopa County, Arizona. (*See* RNSOF, 13). Accordingly, Defendant Richard's activities and contracts with Mid-America establish that Defendant Richard purposely availed himself of the privilege of conducting activities in Arizona.

8. Defendant Wehrly

Defendant Wehrly signed a "Seminar Agreement" with Mid America in 1998. (*See*, ROSOF ¶F17(d)(ii)). Defendant Wehrly signed a "Marketing and Sales Agreement" with Mid America where he agreed to sell Mid America products, including the MAF CGA in exchange for commissions. (*See,* ROSOF ¶F17(d)(iii)). The commission checks paid on four of the five CGA's sold by Defendant Wehrly were paid to a Southwest Estate Planners Inc. (*See,* ROSOF ¶F17(d)(iv)). Defendant Wehrly testified at his deposition that he and his wife were the sole shareholders of Southwest Estate Planners. (*See,* ROSOF ¶F17(d)(iv)). A review of the Arizona Corporation Commission's website details that Southwest Estate Planners Inc. is an Arizona corporation and Defendant Wehrly is the President/CEO. (*See,* RNSOF 14). Notwithstanding Defendant Wehrly's own admissions that he resided in Arizona from

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1995-1998 and maintains an Arizona insurance license, it is abundantly clear that Defendant Wehrly's activities in Arizona, contracts with Mid-America, and the receipt by his Arizona corporation of a majority of his commissions establishes that Defendant Wehrly purposely availed himself of the privilege of conducting activities in Arizona.

D. Receiver's Claims Arise out of or Relate to the Non-Resident Defendants Forum Related Activities.

The Court should apply a "but for" test to determine whether a particular claim arises out of the forum related activities. *Ballard v. Savage*, 65, F. 3d 1495, 1500 (9th Cir 1995). Here, "but for" Defendants contracts, intentional contacts, and the receipt of commissions from Arizona based Mid-America, the Receiver's claims for the return of the fraudulently obtained commissions would not have arisen. It is clear that the receipt of the commissions by the Defendants is directly related to the Plaintiff's claims, satisfying the second prong of the test enumerated in *Lake v. Lake*, 817 F.2d 1416, 1421 (9th Cir. 1987) and *Bancroft & Masters, Inc. v. Augusta Nat'l, Inc.*, 223 F.3d 1082, 1086 (9th Cir. 2000).

E. The Exercise of Personal Jurisdiction over the Non-Resident Defendants is Reasonable

Since the Plaintiff has established the first two prongs of the personal jurisdiction analysis, the Court presumes that the exercise of jurisdiction over the defendants is reasonable. *Ballard*, 65 F.3d at 1500. There is no argument which can support the position that personal jurisdiction over the Non-Resident Defendants is in anyway unreasonable. Each of the Non-Resident Defendants intentionally chose to do business with the Arizona based MAF, most traveled to Arizona to participate in workshops and other activities, and all of the Non-Resident Defendants accepted commissions for the sale of MAF CGAs. Furthermore, all of the Non-Resident Defendants communicated with Mid-America to facilitate the sale of MAF CGAs to the MAF victims. Finally, all of the Non-Resident Defendants have actively participated in this litigation and all phases of discovery. The Non-Resident Defendants have been represented by Arizona counsel and have propounded and responded to numerous discovery requests. Moreover, each of the Non-Resident Defendants have traveled to Arizona for their depositions. Accordingly, the Non-Resident Defendants are not prejudiced in any way by this suit being brought in the U.S. District Court for the District of Arizona. Since no compelling case can be forwarded that personal jurisdiction over these Defendants is unreasonable, this Court must deny Defendants' motion to dismiss all counts of the Plaintiff's complaint for lack of personal jurisdiction.

II. The MAF CGAs Are Securities

A. CGAs Fit the Definition of a Security under Federal and State Law as Either an Investment Contract or a Note or Evidence of Indebtedness

Contrary to the Defendants' assertions, MAF CGAs fall within the definition of a security under Securities Act of 1933, the Securities Exchange Act of 1934 or the Arizona Securities Act.[4] The CGAs fit the definition of a security either as an investment contract or as a note or evidence of indebtedness. (*See,* ROSOF F.26.d)

B. The Definition of a "Security" is Flexible and Adaptive

The United States Supreme Court has consistently emphasized that the definition of a security is flexible and adaptable to meet the endless variety of new investment products and schemes. The securities laws are intended to reach "novel, uncommon or irregular devices, whatever they appear to be." *SEC v. C.M. Joiner Leasing Corp*., 320 U.S. 344 (1943). In *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the Supreme Court noted that the definition of a security "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Id.* at 299. In defining a note, the Supreme Court concluded that "Congress' purpose in enacting the securities laws was to regulate investments in whatever form they are made and by whatever name they are called." *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990). "To that end, (Congress) enacted a broad definition of 'security,' sufficient to encompass

[4] 15 U.S.C. §77b(a)(1), 15 U.S.C. § 78c(a)(10), and A.R.S. § 44-1801(26).

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virtually any instrument that might be sold as an investment." *SEC v. Edwards*, 540 U.S. 389, 393 (2004).

C. The CGAs are Investment Contracts under Federal and Arizona Law

The MAF CGAs are "securities" because they are investment contracts. An investment contract is a scheme which "involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Securities and Exchange Commission v. W. J. Howey, Co.,* 328 U.S. 293, 301 (1946). *See also*, *Nutek Information Systems, Inc. v. Arizona Corporation Commission*, 194 Ariz. 104, 108, 977 P.2d 826, 830 (App. 1998), *cert. denied sub nom.*, *AKS Daks Communications, Inc. v. Arizona Corporation Commission*, 528 U.S. 932, (1999) (Arizona applies the *Howey* test in defining investment contract). Here, it is undisputed that MAF Victims paid money to MAF. In exchange, all funds paid to MAF were to be pooled and each annuitant was promised (under his or her CGA contract) a monthly rate of return on his or her investment, which makes their collective fortunes dependent on the success of a single common enterprise. This horizontal commonality satisfies the common enterprise prong of the *Howey* test. *See Hocking v. Dubois*, 885 F.2d 1449, 1459 (9th Cir. 1989)(*en banc*), *cert. denied*, 494 U.S. 1078 (1990); *Rose v. Dobras*, 128 Ariz. 209, 211, 624 P.2d 887, 889 (App. 1981). The third prong of the *Howey* test is satisfied, because MAF managed and invested the funds provided by the Victims who depended on MAF for their promised payments. Accordingly, the MAF CGAs fit the federal definition of a security under *Howey*, which also meets the Arizona definition of an investment contract.

Although the Defendants claim that the charitable motivation took the CGAs out of the category of a security, the MAF sales materials stressed the investment aspects of the CGAs, including referring to the deposit of funds in the CGA as an investment, and the annuity payments as a "return on your investment." The materials also tout tax benefits that are often associated with investment strategies, including savings on income taxes, capital gains, and estate taxes. (*See,* RNSOF 15). Investors surrendered their

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money and securities believing that they were purchasing a financial instrument that would pay them a guaranteed rate of return and provide tax benefits.

That one of the stated purposes of the CGA was to provide funds to charities does not remove the CGA from the definition of an investment contract. Congress specifically addressed this issue in the *Philanthropy Protection Act of 1995* ("PPA") by noting that because the donor's funds are pooled in a "common enterprise" with "profits" to come solely from the efforts of those who maintain the fund, an interest in a charitable income fund as evidenced by a CGA or other instruments may be an investment contract. *House of Representatives Report 104-333*, *Philanthropy Protection Act of 1995*, p. 6. MAF acknowledged in its contracts that it managed common investment funds subject to the PPA, which specifically includes CGAs. (*See,* RNSOF 16; s*ee, e.g.* 15 U.S.C. § 80a-3(c)(10)). In summary, under federal and Arizona law the MAF CGAs fit the definition of an "investment contract" and are subject to securities regulation.[5]

D. The MAF CGA Fit the Definition of Notes and Evidence of Indebtedness

Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act define a security as including "(a)ny note." Section 2(a)(1) of the Securities Act also lists any "evidence of indebtedness" as a security. Although "evidence of indebtedness" is undefined, commentators argue that the criteria for defining "notes" as securities are helpful in analyzing this type of security. *See,* 2 Loss & Seligman, *Fundamentals of Securities Regulation*, 962-64 (3d ed. 1989 & Supp. 2001).

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[5] The Defendants' reliance on *Corporation Commission v. Equitable Life Assurance Co.*, 73 Ariz. 171, 239 P.2d 360 (1951) is misplaced. That case did not determine whether an annuity could be subject to securities regulation, but decided that an annuity contract was not a contract of insurance and, therefore, not subject to the Arizona premium tax. The Court, however, did characterize an annuity as "an 'investment' of funds." *Id* at 73 Ariz. 176, 239 P.2d 363. The Defendants also attached to their Motion for Summary Judgment two unpublished memoranda by attorneys for a seller of CGAs to bolster their argument that CGAs are not securities. The memoranda are essentially policy arguments in favor of allowing the payment of commissions, which the PPA prohibits. By providing a limited registration exemption, the Congress has concluded that CGAs and other similar instruments are securities.

A note is presumed to be a security, unless it resembles certain types of notes identified by the Supreme Court as excluded from the definition of a security. *See, Reves v. Ernst & Young*, 494 U.S. 56, 65 (1990).[6] Moreover, financial instruments are considered to be securities if (1) the seller's motivation is to raise money or finance investments and the buyer's purpose is to make a profit; (2) there is common trading of the instrument for speculation or investment; (3) the public expects that the instrument is a security; and (4) there is no other regulatory scheme to significantly reduce the risk of the instrument, thereby rendering the application of the securities laws unnecessary.

The MAF CGAs fit most of the foregoing categories: They were described in the contracts as "general obligations" of the company. (*See,* RNSOF 17). In applying the family resemblance test, the MAF CGAs do not resemble any of those notes identified in *Reves* as excluded from the definition of a security. Although the CGAs ostensibly had a charitable purpose, MAF raised money from investors to fund investments which was its only source of revenue, and in exchange the investors expected to receive income and tax benefits as well as making charitable donations. Other factors would support a reasonable expectation that the CGAs were securities: MAF represented that the CGA assets would be invested in stocks, bonds, money market funds, and federal obligations, not unlike a pooled investment or mutual fund (*See,* RNSOF 18) and it was exempt from securities registration requirements, which ordinarily is not required unless the instrument is a security (*See,* RNSOF 19) which provided an exemption from securities registration. Moreover, CGAs are subject to the securities fraud jurisdiction of the Securities and Exchange Commission and state securities regulators (*see, House of Representatives*

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[6] The excluded instruments include "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business . . . "; and "notes evidencing loans by commercial banks for current operations." 494 U.S. at 64.

Report 104-333, *Philanthropy Protection Act of 1995*, pp. 8-9), and there is no alternative comprehensive regulatory regime that adequately protects investors.[7]

E. Fixed Interest Instruments Can Be Securities

The Defendants' argument that the CGAs are not securities because they promised a fixed return is simplistic and wrong. *See, SEC v. Edwards*, 540 U.S. 389 (2004). In that case, the Supreme Court held that a money making scheme is not excluded from the definition of an "investment contract" simply because the scheme promised a contractual entitlement to a fixed, rather than a variable, return. In *Edwards*, the Court emphasized that "(t)here is no reason to distinguish between promises of fixed returns and promises of variable returns for purposes of the test, so understood. In both cases, the investing public is attracted by representations of investment income . . . ." *Id* at 394. The Court rejected the argument that fixed income investments are not securities, because "(u)nder the reading respondent advances, unscrupulous marketers of investments could evade the securities laws by picking a rate of return to promise. We will not read into the securities laws a limitation not compelled by the language that would so undermine the laws' purposes." *Id* at 394-95. The Court also clarified the meaning of "profits" as used in *Howey* as "the profits that investors *seek* on their investment, not the profits of the scheme in which they invest." *Id.* Therefore, MAF's promise of a fixed rate of return does not affect the conclusion that its CGAs were securities.

F. MAF was not an Insurance Company and Its CGAs were not Fixed Annuities

The Defendants argue that the MAF CGAs should be treated like fixed annuities issued by a fully regulated insurance company, which would exempt them from securities registration requirements. In assessing the merits of the Defendants' assertions, however, the Court should evaluate the substance of these investment transactions and not their form. *Tcherepnin v. Knight*, 389 U.S. 332 (1967). In that case the Supreme Court

[7] The Defendants also argue that the anti-trust amendments in 15 U.S.C. § 37(b) affects the status of CGAs as securities. Whatever relief Congress gave charitable organizations from anti-trust laws does not affect the limited exemption from the broker-dealer registration of 15 U.S.C. § 78c(3)(b)(2).

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concluded that cases involving securities should be decided on the basis of the economic realities of the transaction.

In substance, the MAF CGAs had no resemblance to annuity policies issued by an insurance company. MAF itself never pretended that it was an insurance company or that its CGAs were fixed annuities regulated by government agencies, but rather it characterized the CGAs as interests in collective investment funds (*See,* RNSOF 19):

> Common investment funds managed by our organization are exempt from registration requirements of the Federal securities laws, pursuant to the exemption for collective investment funds and similar funds maintained by charitable organizations under the Philanthropy Protection Act of 1995 (P.L. 104-62).

In the same document MAF acknowledged that it was subject to the requirements of the PPA: "Information in this document is provided to you in accordance with the requirements of that Act." (*See*, RNSOF 19). In characterizing its assets as a common investment fund, MAF acknowledged that it resembled a mutual fund rather than an insurance company, or that its CGAs more closely resembled a variable annuity than a fixed annuity. *See, SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959). The fixed return feature of the CGAs did not remove them from the definition of a security. *SEC v. Edwards*, 540 U.S. 389 (2004).

The Plaintiff's securities expert also concluded that MAF was not an insurance company and that its CGAs were not fixed annuities:

> Discounting the fact that the Mid-America CGA was, in reality, a disguised *ponzi* scheme, it was more like an investment pool, or a mutual fund, then a fixed annuity. Mid-America was not an insurance company, with a legitimate business and real revenues, which could back its general obligations to investors under the CGA. Rather, investor proceeds were Mid-America's only source of revenue, and the company acknowledged that it needed to invest these proceeds in "stocks, bonds, money market funds, and federal obligations" and "short-term, intermediate, and long-term investments" in order to meet its obligations. This is more like a variable annuity, which typically is deemed a security, then like a fixed annuity. (Plaintiff's Exhibit 170).

In order for the MAF CGAs to be exempt from securities registration, they would have to qualify for an exemption under the PPA. Since MAF used unqualified sales agents and

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paid them commissions, neither MAF nor its CGAs qualified for an exemption from broker-dealer registration.

G. Whether or not the Defendants Were "Independent Contractors" the Payment of Commissions Invalidated the Exemption from the Broker-Dealer Registration Requirements

The Defendants misconstrue the limited exemption from the broker-dealer registration requirements provided by 15 U.S.C. § 78c(3)(b)(2). That section states that the exemption is unavailable unless "each person who, . . ., solicits on behalf of such charitable organization . . . is either a volunteer or is engaged in the overall fund raising activities of a charitable organization and receives no commission or other special compensation based on the number of the value of donations collected for the fund." Accordingly, persons soliciting funds must either be a volunteer or someone involved in the charitable organizations overall fund raising efforts and not receive performance-based compensation. The legislative history confirms this interpretation:

> The exemption from the Exchange Act broker-dealer provisions is subject to the condition, set forth in paragraph (2) of subsection (e), that any person soliciting donations on behalf of such a charitable organization *must* be either a volunteer or employed in the overall fund-raising activities of a charitable organization, and that such a person *must not* receive any special compensation based on the number or value of donations collected for the fund.

House of Representatives Report *104-333*, *Philanthropy Protection Act of 1995*, p. 14 (Emphasis added). Since the Defendants were self-described independent contractors and were neither volunteers nor involved in the overall fund raising efforts, they were not qualified under the registration exemption to solicit investments. Even if they were qualified to solicit investments, their acceptance of commissions violated the terms of the exemption and would in any event trigger the broker-dealer registration requirements.

The Defendants also make a policy argument in favor of allowing performance-based commissions, and they attach some unpublished papers by attorneys apparently representing or employed by a seller of CGAs, which make essentially the same policy argument that commissions should be allowed under an exemption from registration. By

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enacting the limited exemption prohibiting commissions, the Congress chose the policy that applies to the marketing of CGAs and only Congress can change that policy.

H. Since the CGAs are Securities the Nationwide Service of Process Applies in this Case

Under 15 U.S.C. § 78aa, a federal securities violation permits the application of nationwide service of process. Based on the foregoing arguments, the Plaintiff has alleged and proven in its Motion for Summary Judgment that the MAF CGAs were federal securities supporting nationwide service of process.

III. Defendants' attack upon the Receivership Order is meritless.

The Receiver is an agent of the Court (*see generally, Stowell v. Arizona Savings and Loan, Assoc.* 93 Ariz. 310, 380 P.2d 606 (Ariz. 1963)) and, as such, he is simply carrying out the directions of the Court by pursing his claims seeking the return of commissions which were paid by Dillie to Defendants from MAF funds in order to facilitate Dillie's Ponzi scheme.

Whether the commissions sought by the Receiver should be returned to the Receivership estate as an asset of the estate will determined in the instant plenary proceedings where all due process rights have been, and continue to be, accorded to the Defendants. Thus, the Defendants' attack upon the Receivership Order is meritless. *Cf., SEC v. Wencke et al.,* 783 F.2d 829 (9th Cir. 1986), *cert. denied, DeLusignan v. Gould,* 107 S.Ct. 77 (1986), where following the placement of certain entities into receivership and the Court's order that the Receiver prosecute all claims of the underlying receivership entities in order to seek the return of receivership assets to the receivership estate, summary proceedings for the disgorgement of stocks and profits therefrom the Receiver claimed were receivership assets was held to be proper even though the recipient had not participated in the original underlying SEC action that gave rise to the appointment of a receiver.[8]

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[8] Further, the Defendants' argument that the Receiver is attempting some novel strategy by seeking the return of the commissions is unfounded. *See, e.g., In re World*

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IV. The Receiver has standing to bring his claims for declaratory/equitable relief (count five), equitable disgorgement (count 11).

It is clear from *Scholes v. Lehmann,* 56 F.3d 750 (7th Cir. 1995), *cert. denied, African Enterprise, Inc. v. Scholes,* 116 S.Ct. 673 (1995), that where a Receiver's claims seek redress for injuries to the underlying receivership entities/persons, the Receiver has standing to bring his claim. (*See also, SEC v. Cook,* 2001 WL 256172 (D.C. Tex. 2001).

Scholes, supra, involved a receiver's fraudulent transfer claims. The Court there held that the receiver had standing to bring claims of fraudulent transfer to seek the return of funds which had been diverted by a Ponzi scheme operator from the underlying receivership entities he had previously controlled where his transfer of corporate funds injured the corporations. The Court noted that the Ponzi scheme operator, as sole shareholder of the corporations, could have lawfully ratified the diversion of corporate assets but only if creditors were not harmed. Similarly, here, Dillie used MAF funds (via MAF or MAFG) for the purpose of perpetuating his own Ponzi scheme and each transfer of MAF funds rendered MAF or MAFG into further and deeper insolvency. (*See,* ROSOF A.4, A.6.)

The Court in *Scholes* explained that once a receiver was appointed and the wrong-doing Ponzi operator was removed from the control of corporations he had previously used as tools in his Ponzi scheme, "[t]he corporations were no more [the wrongdoer's] evil zombies. Freed from his spell they became entitled to the return of the moneys --for the benefit . . . of innocent-investors--that [the wrong-doer] had made the corporations divert to unauthorized purpose." *Id.,* 56 F. 3d at 754. Similarly, here, counts five, ten and eleven are each based upon distinct injury to MAF caused by Dillie's transfer of funds to operate his Ponzi scheme. The Receiver seeks the return of the commissions so they may be equitable distributed to the MAF Victims i.e., creditors of MAF.

Vision Entertainment, Inc., 275 B.R. 641 (Bankr. Fla. 2002); *SEC v. Cook,* 2001 WL 256172 (D. Ct. Tex. 2001); and *In re Randy,* 189 B.R. 425 (Bankr. Ill. 1995).

Defendants argue for summary judgment on counts five (unjust enrichment) and eleven (equitable disgorgement) on the narrow basis that: 1) the Receiver lacks standing on the unjust enrichment claim because the claim is "personal" to the MAF Victims (i.e., there was no distinct injury to the Receiver); and, 2) imposing a constructive trust over the commissions or ordering the disgorgement of the commissions, is inequitable because the Defendants are "innocent" victims. (*Defendants' Motion*, pps. 41-42, 49-51, fn. 22.)

As to the first argument, Defendants have presented no facts disputing the Receiver's claim that Dillie was operating a Ponzi scheme using MAF and MAFG as his tools (similar to the wrongdoer in *Scholes, supra*, who also used corporate entities to perpetuate his fraud scheme). (*See,* ROSOF A. 2-6.) Two things happened when Dillie took moneys from MAF to pay Defendants for facilitating his Ponzi scheme. First, the Defendants were paid for selling fraudulent CGAs that plunged MAF into deeper and deeper insolvency. (*See,* ROSOF A.4) Second, the moneys paid to Defendants as commissions also plunged MAF into further insolvency. (See, ROSOF A.6) Thus, the Receiver for MAF has shown undisputed facts proving MAF as well as its creditors were distinctly injured by the payment of commissions to Defendants and, thus, Defendants' argument on standing must fail.

The Defendants also argue that the Court should not use its equitable powers to impose a constructive trust over the commissions paid to Defendants because they are "innocent" relying upon *U.S. v. Real Property etc.,* 89 F.3d 551 (9th Cir. 1996).[9] (*Defendants' Motion*, pps. 41-42.) The Court in *Real Property, supra,* refused to allow one victim of a fraud to use tracing fictions to advance its claims to recovered funds over the claims of other fraud victims. The instant matter does not involve competing claims of victims. It does involve the inequity of permitting Defendants to retain commissions they earned through facilitating Dillie's Ponzi scheme by marketing and selling

[9] Defendants argue that the Receiver's "constructive trust" claim in count *three* also must be dismissed because a constructive trust is a remedy not a claim. (*Defendants' Motion*, p. 39.) The reference to a "constructive trust" in count three should be construed as a request for a remedy for the underlying claim of "secret profits."

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fraudulent CGAs to elderly people throughout the United States. (*See,* ROSOF A.1-6.) The MAF Victims were promised that the MAF CGAs would provide them with a stream of income, tax advantages and would act as a vehicle by which they could make a donation to a charity of their choice upon their death. (*See,* ROSOF A.1.) Instead, the MAF Victims were scammed.

Defendants' argument that they "are 'innocent parties' here" and likening themselves to the MAF Victims is unfounded. (*Defendants' Motion,* 41:19-20.) Apparently, Defendants rest their argument upon a strangely inverted sense of pity rather than facts because the undisputed facts of this case show that the Defendants violate state and federal laws in the sale of the fraudulent CGAs that were enacted to protect consumers[10] and they abjectly failed to meet even minimum industry standards of due diligence by requesting an audited financial statement before selling the CGAs to elderly members of the public. (*See,* ROSOF F.1.a. i-vi; F. 2.a; F.7.a. i-x; F.8.a.; F.9.a.i.-iv; F.10.a.; F.11.a; F. 12. a. i-vii; F.12. b.i-xii; F.13; F.14; F.15. a. c; F.16; F.22 a-kk; F.24 a-i; F.25 a-d; F.26a-b.)

Not a single Defendant took the most basic and elementary step of obtaining and examining an audited financial statement for MAF before selling the MAF CGAs thereby violating industry standards for the proper sale of financial products. (*See,* ROSOF F.22.a-kk; F.26. a-b) The Receiver's well-qualified expert on industry standards applicable to the sale of the MAF CGAs stated that one of the most important steps that Defendant should have taken before selling the MAF CGAs was obtaining an audited financial statement for MAF for the past three years. (*See,* ROSOF F.26.a-b.) Had the Defendants simply refused to sell the MAF CGAs without an audited financial statement, the sad debacle foisted upon the elderly Ponzi scheme Victims, in large part, could have been avoided. The Defendants don't dispute that one of them asked for an MAF or MAFG audited financial statement and then proceeded to sell the CGAs despite not

[10] Each Defendant violated at least one statute. Some sold securities while unlicensed to do so; some sold CGAs that were not authorized for sale in the particular state in which the Defendant sold MAF CGAs

receiving it; (*see,* ROSOF F.22.p; F.12.b.vi)[11]; one asked for the financial statement after selling most of the CGAs though not all (*see,* ROSOF F.22.z-aa; F.15.a.xiv; F.15.c.i-x); most just didn't even bother to make the request. (*see,* ROSOF F.22.a; F.22.g; F.22.j; F.22.m; F.22.hh; F.22.ii)

Not receiving an audited financial statement upon request is a red flag warning that the financial condition of MAF or MAFG was unverified, and thus, was subject to question. In fact, Defendant Kerher stated that, *after* selling the MAF CGAs, he stopped selling any additional MAF CGAs based upon his failure to receive audited financial statements from MAF explaining: "Any company Defendant requests something from that does not provide the information or documentation would make Defendant consider looking elsewhere." (*See*, ROSOF F.22.u.)

The Defendants' failure to acquire an audited financial statement before selling the CGAs should be interpreted as extreme recklessness and callous indifference to the MAF Victims. In fact, Defendant Lankford summed it up best when he testified that he "wanted to see audited financial statements that would show . . . [him] that . . . [his] clients' money was safe." An audited financial statement would have shown "[w]ell , it would have come from an auditing group whether KPMG or any of the other big ones. And it would have shown me the audited returns, the physical returns audited and certified by that accounting group. So . . . [he] would know what they were – what their financial position was." (*See,* ROSOF 15. b. i.)

Defendant Lankford also testified that without an audited statement there was no way to confirm the number of dollars MAF stated it had in reserves to cover its charitable gift annuity obligations. "That's why I was screaming for an audited financial statement." (*See*, ROSOF 15.b.ii.) Unfortunately, Lankford's screaming apparently took place *after* he had already sold twenty-nine fraudulent MAF CGAs (*and before* he sold two more still without first acquiring an audited financial statement). (*See,* ROSOF

[11] Defendant Kerher stated that he " . . . believed it to be prudent and reasonable to request audited financial statements." (*See*, ROSOF F. 22. q)

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F.15.a.xiv; F.15.b.ii; 15. c.vi.) (*See generally*, Lankford's testimony and statements regarding audited financial statements at ROSOF F.15. b. i-ii; F. 15. c. i-x.).

Defendants' commissions should be returned to the Receiver so he may equitably distribute the moneys to the MAF Victims. *See, Burch & Cracchiolo, P.A. v. Pugliani et al.,* 144 Ariz. 281, 285, 697 P.2d 674, 678 (Ariz. 1985) holding: "A constructive trust is an equitable remedial device, generally used to prevent unjust enrichment. (Citations omitted.) In particular, a constructive trust will arise whenever it is inequitable that property should be retained by the legal title holder."[12]

In fact, under the undisputed facts of this case, the Court not only should deny the Defendants' motion for summary judgment on the Receiver's equitable claims in counts 5 and 11, it should grant summary judgment to the Receiver. *See, Kassbaum v. Steppenwolf Productions, Inc.,* 236 F.3d 487, 494 (9th Cir. 2000), *cert. denied., Steppenwolf Productions, Inc. v. Kassbaum,* 122 S.Ct. 41 (2001), holding that "[i]t is generally recognized that a court has the power sua sponte to grant summary judgment to a non-movant when there has been a motion but no cross-motion." *See also, Cool Fuel, Inc. v. Connett,* 685 F.2d 309 (9th Cir. 1982); *Jackson v. Nassau County Board of Supervisors,* 818 F.Supp. 509, 535-536 (D.C. N.Y. 1993). [13]

V. The Receiver may bring Count 10 (conversion)[14]

The Defendants argue that they should be granted summary judgment on the Receiver's claim for conversion because the Receiver lacks standing to bring it. Again, the undisputed facts show that MAF suffered a distinct injury based upon the wrongful taking of funds from MAF by Dillie to perpetuate his Ponzi scheme to the financial peril

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[12] *See also, Johnson v. American National Insurance Co.,* 126 Ariz. 219, 613 P.2d 1275 (Ariz. App. 1980); *Sadacca v. Monhart,* 128 Ill. App.3d 250, 470 N.E. 2d 589, 83 Ill. Dec. 463 (Ill. App. 1984).)

[13] Last, the Defendants' argument that equitable disgorgement also is not appropriate because some MAF Victims may have been compensated in certain instances is specious. Any such concerns can be addressed in the MAF claims process that is now underway.

[14] Although the Defendants treat the arguments as to counts 7, 8, and 10 under the heading of failure to state a claim, in reality, their arguments are based upon standing.

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of MAF. These funds were then transferred to the Defendants for facilitating the Ponzi scheme. Accordingly, the Receiver has standing to bring his conversion claim.

VI. The Receiver may bring Counts 7 & 8 (federal and state securities violations)

The Receiver has standing to bring his claim of federal securities fraud, as alleged in Count Seven, under the holding of *Superintendent of Insurance of the State of New York v. Bankers Life and Casualty Co.,* 404 U.S. 6, 92 S.Ct. 165, 168 (1971). There, the U.S. Supreme Court held that the section 10(b), 15 U.S.C. §78j(b) of the Securities Exchange Act " . . . outlaws the use 'in connection with the purchase or **sale**' of any security [footnote omitted] of 'any manipulative or deceptive device or contrivance.' The Act protects corporations as well as individuals who are sellers of a security. (Emphasis added.)" The Defendants don't dispute that they made misrepresentations in the sale of MAF CGAs (s*ee, Defendants' Motion*, pps. 22-23). Therefore, they fall within the ambit of the Receiver's standing.

The standing of a Receiver to bring securities claims in a case arising out of a Ponzi scheme is not a new concept. *See, Marion v. TDI, Inc.,* 2004 WL 1175740 (D.C. Pa. 2004) holding that a Receiver had standing to bring federal securities fraud claims against sellers of worthless securities in the name of a receivership entity used as part of a Ponzi scheme thereby causing an increase in the liabilities of the receivership entity. Likewise, the same rationale should apply to the state security fraud claim presented in count eight which prohibits the use of any contrivance (e.g., misrepresentation) in the sale of a security. *See,* A.R.S. §44-1991.

When Defendants sold the MAF CGAs through the use of misrepresentations, MAF and MAFG were harmed because each sale continued and deepened their insolvency leaving them unable to pay their lawful creditors. (*Cf., Scholes v. Lehmann, supra,* holding that transfer of funds from corporation for unauthorized purposes by Ponzi scheme operator harmed corporation where transfers harmed creditors of the corporation; *In re Randy, supra,* holding that brokers who received commissions for helping to

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perpetuate a Ponzi scheme, knowingly or not, gave no value for the commissions since the underlying contract to sell the fraudulent product was illegal. In essence, Defendants' misrepresentations aided and abetted the Ponzi scheme orchestrated by Dillie in the process of which MAF and MAFG were badly abused by Dillie. [15]

VII. The Receiver Timely Brought his Claim for Fraudulent Transfer (Count Nine).

A. The time limits of A.R.S. §44-1009(A)(1) are not applicable to the Receiver.

The Defendants' attempt to avoid the claim of fraudulent transfer (Count 9) under the time limitations set forth in A.R.S. §44-1009(A)(1). To start, these time limitations do not apply to the Receiver. The Receiver's lawsuit against the Defendants emanates from, and his claims are ancillary or supplemental to, an action initiated by the SEC against Robert Dillie in *SEC v. Robert R. Dillie et al.,* CIV-01-2493- PHX (JAT). The SEC action was brought as part of its governmental function to protect the public from the harm done to it by defrauding wrongdoers such as Dillie.

In a similar case, the Arizona Supreme Court held that the statute of limitations did not run against the Receiver under the common law rule of *nullum tempus occurrit regi*—"time does not run against the king."[16] *See, In re Diamond Benefits Life Ins. Co.,* 184 Ariz. 94, 907 P.2d 63 (Ariz. 1995).[17] (Whether the time limits placed in A.R.S. §44-

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[15] Defendants' reliance on *Scholes v. Schroeder,* 744 F. Supp. 1419 (D.C. Ill. 1990) is misplaced in connection with the Receiver's count eight (state securities fraud) which has no "reliance" requirement.

In any event, *Scholes v. Schroeder* (which pre-dates *Scholes v. Lehmann, supra,* by five years*)* states that a claim for federal securities fraud could stand if authority could be provided for the Receiver's bringing of the claim by the "seller" of securities against its own agents for their fraud in the course of selling those securities. That authority is presented in section V of this Response.

Last, at pages 23 and 24 of their Motion (Argument 9 b), the Defendants cite *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) and *Hochfelder v. Midwest Stock Exchange*, 503 F.2d 364 (7th Cir. 1974), apparently in support of their argument that the Receiver lacks standing to sue them under the federal and state securities acts. Neither case addresses the standing issue.

[16] The Sixth Circuit Court of Appeals in *U.S. v. Weintraub,* 613 F.2d 612, 618 (6th Cir. 1979, cert. denied, *Weintraub v. U.S.*, 100 S.Ct. 2987 (1980)), explained the rationale supporting this common law rule is to protect the public.

[17] In *Diamond Benefits*, the question was whether the Receiver fell within the auspices of A.R.S. §12-510 which codified the common law doctrine *nullum tempus occurrit regi* in cases involving State action. Here, the Receiver is acting under a

1009(A)(1) is a statute of limitation or a statute of repose matters not as the common law rule has equal application to both.[18]) Under the same common law rule, the doctrine of laches, too, does not run against the government. (*See, U.S. v. Weintraub,* 613 F.2d 612, 618 (6th Cir. 1979).)

In *Diamond Benefits*, a Deputy Receiver who had been appointed to an insolvent insurance company brought a conversion claim in receivership-related litigation to recover assets of the receivership. The defendant argued that the claim of the Deputy Receiver was barred by the statute of limitations. The Arizona Supreme Court disagreed and held that while the creditors (i.e., policyholders) of the insurer would be benefited by the Receiver's claim so, too, in a larger sense would the public at large. The Receiver was appointed to act as part of a legislative scheme that was designed to safeguard the public interest from insurers who failed to comply with their obligations under the law. The Deputy Receiver was simply performing his duties as part of this broader framework when he sought his conversion claim seeking the return of receivership assets to the receivership estate. Thus, the Receiver's action was likened to State action so to invoke his exemption from the limitations period applicable to his conversion claim. (*See also*, *Warfield v. Gardner,* 346 F.Supp.2d 1033 (D.C. Ariz. 2004) holding that limitations period did not apply to equity Receiver whose appointment was requested by the State following initial action of the State that was based upon state forfeiture and racketeering statutes.)

Similarly, here, the federal government has enacted a legislative scheme that is intended to protect the citizens of our nation from those who prey upon them using fraud and deception. (*See,* RNSOF 21) As part of this legislative scheme, the government (i.e.,

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Congressional legislative scheme; however, for purposes of substantive analysis, this is a distinction without a difference. The common law rule *nullum tempus occurrit regi* applies to the federal as well as the state governments. *See, U.S. v. Noojin*, 155 F.377 (D.C. Ala. 1907) The substantive analysis of *Diamond Benefits*, thus, remains instructive.

[18] *See, People v. Asbestospray Corp.,* 247 Ill. App.3d 258, 616 N.E.2d 652, 186 Ill. Dec. 462 (Ill. App. 1993), cert. denied, *People v. Asbestospray*, 152 Ill.2d 564, 622 N.E.2d 212, 190 Ill. Dec. 895 (Ill. 1993).

the SEC) asked this Court to appoint a Receiver so that the greater purpose of that scheme could be accomplished, i.e., to help provide a remedy for those who were harmed by the fraud. Accordingly, for purposes of the common law rule *nullum tempus occurrit regi,* the Receiver is acting on behalf of the SEC insofar that his claims are an extension of the government's original action designed to safeguard the public interest.[19]

The common law rule *nullum tempus occurrit regi* thus should be held applicable to the Receiver in the instant case just as it was to the Receivers in *Diamond Benefits* and *Warfield v. Gardner, supra.* Therefore, the time limitations set forth in A.R.S. §44-1009(A)(1) do not apply to the Receiver.

B. The Receiver met the four year time period.

The Receiver was appointed on December 20, 2001. The Complaint in the instant litigation was filed on December 3, 2003. Since, the four year time limitation for filing the Complaint, *assuming arguendo* it is applicable to the Receiver, should not commence until the Receiver has been appointed, the fraudulent transfer claim was timely filed.

First, the Arizona Supreme Court has not yet definitively determined whether the limitations period set forth in A.R.S. §44-1009(A)(1) is a statute of repose or a statute of limitations. The Arizona Court of Appeals in Division Two, referred to the limitations period as a statute of repose in *Moore v. Browning*, 203 Ariz. 102, 50 P.3d 852 (Ariz. App. 2002) but that case did not address why the Court referred to the time period as a statute of repose as opposed to a statute of limitations. Instead, the case centered on whether a transfer of funds or the receipt of a judgment by a creditor commenced the running of the four year limitations period. At best, the Court's reference to the limitations period as a "statute of repose" is merely *dicta*.

[19] Additionally, if in the highly unlikely event any moneys were left over in this receivership after distribution to the Victims of the Receivership was completed, the remaining monies would be deposited in the U.S. Treasury in payment of the $120,000 civil penalty that was imposed by the United States District Court in *SEC v. Robert R. Dillie et al., supra,* since the SEC would be the last creditor of the receivership estate to be paid. (*See,* RNSOF 20) Accordingly, the public interest, again, would be served via the receivership.

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The Court in *Hill v. MTLC,* 332 B.R. 835 (Bankr. Fla. 2005), however, was asked to determine if Florida's counterpart to A.R.S. §44-1009(A)(1) was a statute of repose or a statute of limitations and held it was the latter because the time for bringing a fraudulent transfer action was not cut off after a specified time strictly measured from the date of the transfer of funds. This comports with Arizona's view of the difference between a statute of limitations and a statute of repose. *See, Vales v. Kings Hill Condominium Assoc.,* 467. Ariz. Adv. Rep. 22, 125 P.3d 381, 384, fn.1 (Ariz. App. 2005). Here, claims made under A.R.S. § 44-1004(A)(1) are not required to be made with a strictly defined time period; rather a plaintiff may bring a claim within four years after the transfer was made or obligation was incurred **or**, within one year after the fraudulent nature of the transfer or obligation was or through the exercise of reasonable diligence could have been discovered by the claimant.

Accordingly, the time period in A.R.S. §44-1009 (A)(1) is more properly viewed as a statute of limitations subject to equitable tolling which is recognized under Arizona law. "Adverse domination" is a form of equitable tolling that tolls a time limitation period while the plaintiff cannot bring a claim while it is under the domination of another in a manner adverse to the plaintiff.[20] There can be no legitimate dispute that MAF and MAFG were under the adverse domination of Dillie who was draining them of MAF monies in order to fund his Ponzi scheme. During this time, Dillie treated MAF monies as his own in furtherance of his Ponzi scheme regardless of the harm to MAF. (*See,* OSOF A.3-6.) Accordingly, the four year time limitations period in A.R.S. §44-1009(A)(1) should not commence until fraudulent transfer claims on behalf of MAF and MAFG could be brought, i.e. upon the appointment of the Receiver. (*Cf., Quilling v. Grand* Street *Trust,* 2005 WL 1983879 (D.C. N.C. 2005) applying doctrine of adverse domination to toll the one year time limit under California's equivalent of A.R.S. §44-

[20] While no Arizona Court has yet ruled whether this doctrine would be recognized in Arizona, the United States District Court for the District of Arizona has ruled that the Arizona Courts would recognize this doctrine if presented with it. (*See, RTC v. Blasdell,* 930 F.Supp. 417 (D.C. Ariz. 1994); *FDIC v. Jackson,* 133 F.3d 694 (9th Cir. 1998).)

1009(A)(1) where the Receiver had been appointed to take over a company that had been used as part of a Ponzi scheme.)

C. The Receiver met the one year time period.

The Receiver also met the one year requirement set forth in of A.R.S. §44-1009 (a)(1). The Receiver made his claim within one year after the claim could reasonably have been discovered. As set forth in detail in the Receiver's Declaration accompanying the Response to Defendants' Facts, the Receiver was unable to uncover the facts showing the fraudulent nature of the commission payments to Defendants prior to the one year period before December, 2003 for numerous reasons including the Receiver was forced to chase MAF business records around the country while they were absconded by or through Dillie's actions; the Receiver was forced to seek numerous hearings before the Court to force Dillie to reveal information that would ultimately lead to the revelation that he provided no audited financial statement for MAF or any other requisite financial information to the Defendants before they sold the MAF CGAs; the Receiver had to sort through hundreds of thousands of MAF business records that were delivered to him in disarray; and he had to wait through interminable delays to depose Dillie caused by such events as Dillie's escape from jail. (*See,* RNSOF 23-43).

Defendants mistakenly argue that the Receiver was required to plead the facts underlying the "due diligence" section of the limitations period in his complaint (even though the defense of "statute of limitations" and "statute of repose" are affirmative defenses) relying on *Browning, supra.*[21] The Court in *Browning* did not so hold. It merely stated that the burden of proof shifts to the plaintiff to show that his claim was tolled by the discovery rule when the plaintiff has not met the four year requirement. Even if the Defendants' argument was correct and applicable, this Court should allow the Receiver to amend his Complaint for the very limited and narrow purpose of including

[21] The Defendants did not raise the "statute of repose" as an affirmative defense in their Answer. Any matter constituting an avoidance must be specifically pled pursuant to Rule 8(c), Fed. R. Civ. P.

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the facts set forth in this Response regarding the due diligence of the Receiver in filing his complaint.

For all the foregoing reasons, the Court should deny Defendants' motion for summary judgment as it relates to the fraudulent transfer claim.[22]

VIII. The Receiver has standing to bring counts one –four and six of his Complaint.

Defendants argue that the Receiver lacks standing to advance his claims in counts one through four and six (breach of fiduciary duty, constructive fraud in a confidential relationship, secret profits, negligence and gross negligence and fraud, respectively). The Receiver's standing to bring these claims in issue is founded upon an analysis of receivership cases that have emerged where public policy is involved. In *Cordial v. Ernst & Young,* 199 W.Va. 119, 483 S.E.2d 248 (W. Va. 1996), the Court held that a Receiver has standing to bring claims in the interests of the creditors of the receivership entities on public policy grounds. In that case, the Receiver and the Deputy Receiver of Blue Cross and Blue Shield of West Virginia brought to trial claims of professional negligence, negligent misrepresentation, fraud and breach of contract resulting from auditing and other professional services provided by the defendant-accounting firm to the receivership entity prior to its being placed into receivership. The accounting firm argued that the Deputy Receiver had no standing to bring the claims on behalf of "creditors and policyholders." *Cordial v. Ernst & Young, supra*, 483 S.E. 2d at 256. The argument of the accounting firm continued that the Deputy Receiver could only assert those claims that the receivership entity could itself have brought.

The Court disagreed noting that the receivership was part of a governmental scheme by which a Receiver could be appointed to a financially impaired insurance company in order to protect policyholders, creditors, shareholders or the public.

[22] In addition, ARS §12-501 provides that time limitations do not run while a defendant is out of state. Defendants Carroll, Bidwell, Derk, Frazier, Kerher, Lankford and Richard live out of state and, in fact, are claiming they do not even meet the minimal personal jurisdictional contacts with the State. While their jurisdictional analysis is incorrect, their absence from the state tolls any time limitations applicable to claims against them.

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Therefore, the Receiver could pursue claims of the creditors and the public. *Cordial v. Ernst & Young, supra*, 483 S.E. 2d at 257.[23]

The analysis in *Cordial* has striking application to the instant case where the receivership emanates from the regulatory authority provided to the SEC to enjoin wrongdoers (such as Dillie) from violations of the federal securities laws and to seek the appointment of a receiver to assist the Court in taking control of the assets of the receivership entities and marshaling them for the benefit of defrauded investors and, more broadly, for the protection of the investing public. (*See,* RNSOF 21).

Thus, the principle provided in *Cordial* should be read to permit standing by the Receiver in the instant case to bring the breach of fiduciary duty, and other claims asserted on behalf of the investors-creditors in order to seek the recovery of receivership assets. In both cases, the interest of all creditors as a collective whole are served through the return of receivership assets to the receivership estate for equitable distribution[24] and, in both cases, this approach also serves to protect the public at large. *See also, Craft v. Sunwest Bank of Albuquerque, N.A.,* 84 F. Supp.2d 1226 (D.C. N.M. 1999).

The Receiver is not attempting to bring claims on behalf of individual investors in order to redress their individual injuries for each of their individual benefit. All of the investors were similarly victimized and the Receiver is attempting to recover receivership assets (i.e., the commissions) related to their collective victimization for equitable distribution to all. Similar to the insurance liquidation/rehabilitation cases, the Receiver's appointment in this case originally emanated from the bringing of an action by a regulatory agency, here the SEC. Further, the purpose of the instant receivership, similarly reflected in the statutory purpose underlying the insurance receiverships, is to

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[23] Similar to the concern of the Insurance regulatory scheme over the impact of defunct insurers upon policyholders and creditors, the Securities and Exchange Commission regulatory scheme is concerned with the impact of fraud upon creditors of corporations. *Superintendent of Insurance of the State of New York v. Bankers Life and Casualty Co. et al., supra*, 92 S.Ct. at 169, fn. 8.

[24] Indeed, this Court, too, has recognized in its "Order" dated March 22, 2004 (related to Petition No. 6 in this receivership matter) that a receiver does not merely step into the shoes formerly worn by the entities in receivership and, thus, has more latitude to recover receivership assets than the underlying receivership entities could have asserted.

ensure the disgorgement of ill-gotten gains and the equitable distribution of those funds to the victims.

While the Receiver does not ignore the more narrow view presented in *Scholes v. Lehman, supra,* holding that the Receiver has standing to bring claims where injury can be connected to the receivership entities as well as the creditors thereof, that rationale should now be read more broadly consistent with the public policy aims discussed *supra,* which post-date the *Scholes v. Lehman* opinion.[25]

IX. Summary

For all of the foregoing reasons, the Defendants' motion for summary judgment should be totally denied. Additionally, summary judgment on counts five and eight seeking unjust enrichment and equitable disgorgement should be granted to the Receiver.

Respectfully submitted this 1st day of February, 2006.

GUTTILLA & MURPHY, PC

s/Ryan W. Anderson
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PROOF OF SERVICE

This is to certify that a true copy of the foregoing Response and Opposition to Rada Defendants' Motion for Summary Judgment has been filed electronically with the Court and that the persons on the service list below designated as "CM/ECF Registered" will be served with same by the Court's CM/ECF system; and that the other persons on the service list below have been served with a copy of the Response and Opposition by first class mail this 1st day of February, 2006.

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[25] The Defendants' reliance on *Lafond v. Davis*, an unpublished opinion of the Supreme Court of Massachusetts, is misplaced since it has no precedential value.

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