

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

S. GREGORY HAYS, as receiver
for Mobile Billboards of
America, Inc., et al.,

Plaintiff,

v.

DAVID E. ADAM, et al.,
Defendants.

CIVIL ACTION

NO. 1:05-CV-2705-CAP

O R D E R

This action is presently before the court on the motion to dismiss [Doc. No. 267] filed by Gregory Bartko on behalf of defendants Alternative Financial Concepts, LLC; Arthur Anderson; Arthur Anderson Retirement Planning, Inc.; Timothy L. Bradshaw; CLR Group, Inc.; Daniel S. Dark; Freedom Capital, LLC; James K. Gibson, Jr.; Keith Gibson; Victor Graham; Gibson & Associates, Inc.; Michael L. Lawson; Levonda Leamon; Legacy Estate Concepts, Inc.; Clarence J. Lyon, II; Rebecca Plummer; Elisabeth Rainey; James Rainey; Hugh Thacker; Craig Warner; and Gary P. Walker (collectively, the "defendants").

Factual and Procedural Background

The following facts are derived from the complaint and construed in a light most favorable to the plaintiffs. From 2001 through 2004, Mobile Billboards of America, Inc. ("MBA") used a network of sales agents to sell more than \$60 million in bogus

mobile billboard investments to investors as part of a massive Ponzi scheme. The sales agents, including the defendants in this case, were members of organizations assembled by "master sales agents." MBA typically paid a 27% commission per billboard sale to one of the master sales agents, who in turn made a commission payment to the individual within his or her organization that actually made the sale. The agents received sales commissions and bonuses for their participation in the mobile billboard scheme. These high commission rates were not disclosed to investors during the sales process.

The plaintiffs claim that the fraudulent billboard investments sold by the sales agents were unregistered securities. The agents sold the unregistered securities and received commissions from the sales even though they were not registered securities dealers. The Ponzi scheme was dependent upon the sales agents' efforts in soliciting investors. Agents were compensated with more than \$19 million in commission payments.

In September 2004, the Securities and Exchange Commission ("SEC") filed an enforcement action, Civil No. 1:04-CV-2763-WBH, in this court against MBA and affiliated entities and individuals. Plaintiff S. Gregory Hays was appointed the Receiver for MBA and its affiliated businesses. The Receiver filed this action on October 18, 2005 [Doc. No. 1], seeking an accounting and recovery

of the commissions and bonuses paid to the defendants pursuant to the investment scheme. The defendants filed the motion to dismiss now under consideration on October 9, 2006 [Doc. No. 267].

Legal Analysis

The defendants argue that the Receiver's complaint should be dismissed pursuant to Federal Rule of Civil Procedure 12(b)(6) based on the doctrine of *in pari delicto*. Essentially, the defendants argue that because MBA and its affiliated entities perpetrated the fraud, the Receiver lacks standing to bring claims against the defendants. As this court has already held in Hays v. Paul, Hastings, Janofsky & Walker LLP, No. 1:06-CV-754-CAP [Doc. No. 31, at 25-27] (N.D. Ga. Sept. 14, 2006), however, this argument fails.

Under both Georgia and federal law, *in pari delicto* is an equitable doctrine. Banco Industrial de Venezuela, C.A. v. Credit Suisse, 99 F.3d 1045, 1050 (11th Cir. 1996); Bell v. Sasser, 238 Ga. App. 843, 848, 520 S.E. 2d 287, 293 (1999). The doctrine states that "a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing." Black's Law Dictionary 794 (7th ed. 1999). This common law defense "derives from the Latin, *in pari delicto potior est conditio defendentis*: In a case of equal or mutual fault . . . the position of the [defending] party . . . is the better one." Bateman Eichler, Hill

Richards, Inc. v. Berner, 472 U.S. 299, 306, 105 S. Ct. 2622, 2626 (1985). The doctrine is based on the policy that "courts should not lend their good offices to mediating disputes among wrongdoers" and "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality." Id.

The defendants argue that Georgia courts would bar the Receiver from pursuing them for the (ultimate) benefit of defrauded investors. As it previously held in Paul, Hastings, however, the court concludes that it is likely that Georgia courts would not apply the defense of *in pari delicto* under the circumstances of this case. Georgia law follows the well-settled maxim that "equity seeks to do equity," O.C.G.A. § 23-1-8 (2004) ("Equity considers that done which ought to be done and directs its relief accordingly"), and Georgia courts have historically exercised their equitable powers to bar the use of equitable defenses where the result would be harm to innocent third parties, such as creditors. See Brooke v. Kennedy, 172 Ga. 461, 158 S.E. 4 (1931). This is so because the doctrine of *in pari delicto* "is based on the principle that to give the plaintiff relief would contravene public morals and impair the good of society. Hence, it should not be applied in a case in which to withhold relief would, to a greater extent, offend public morals." Gaines v. Wolcott, 119 Ga. App. 313, 317,

167 S.E.2d 366, 370 (1969), aff'd, 225 Ga. 373, 169 S.E.2d 165 (1969).

If the court were to apply the doctrine of *in pari delicto* in this case, the result would be the protection of the alleged wrongdoers and the punishment of the innocent victims. Thus, the court concludes that Georgia courts would look to the equities of the situation and refuse to bar relief where the one *in pari delicto* is eliminated from the suit and the recovery would ultimately go to innocent victims.

The court notes that the defendants' argument in the motion at hand relies largely on the Seventh Circuit's decision in Knauer v. Jonathon Roberts Financial Group, Inc., 348 F.3d 230 (7th Cir. 2003).¹ Knauer, however, is not controlling law for this court and in fact represents a minority position on the issue. Moreover, Knauer is factually distinguishable from the instant case. In Knauer, the receiver sued brokerage houses that maintained the securities licenses of the perpetrators of a Ponzi scheme under theories of negligent supervision and respondeat superior. Id. at

¹ The defendants also cite a number of bankruptcy cases to support their argument. However, the Eleventh Circuit has made it clear that a bankruptcy trustee is governed by the Bankruptcy Code, which does not apply in this case. See Official Committee of Unsecured Creditors of P.S.A., Inc. v. Edwards, 437 F.3d 1145 (noting that the case was governed by the Bankruptcy Code and not the law governing receiverships). The bankruptcy cases cited by the defendants are thus inapplicable.

234. However, in Knauer, unlike this case, there was "no allegation whatsoever that the defendants were directly involved [in] or benefitted" from the fraud. Id. at 237. The court noted that if there had been direct involvement, or if the brokerage houses had received some tangible benefit from the Ponzi scheme, it would have reached a different decision. Id. at 237, n.6. In the case at hand, taking the allegations in the complaint as true, the defendants not only directly benefitted from the Ponzi scheme, they in fact directly facilitated it.

Accordingly, the court finds that the Seventh Circuit's decision in Scholes v. Lehmann, 56 F.3d 750 (1995), regarded as the touchstone case on this issue, is more analogous to this case. See Stenger v. World Harvest, No. 1:04-CV-151-RWS, 2006 U.S. Dist. LEXIS 15108, at *15 (N.D. Ga. March 32, 2006) (noting that Scholes is "the seminal case in this area of the law"). In Scholes, the receiver sought to recover from defendants who were some of the primary recipients of funds from a Ponzi scheme. Id. at 755-61. The court held that because the receiver only sought to maximize the value of the receivership corporations for the benefit of their creditors and investors, the receiver was not barred from recovering corporate assets from the defendants. Id. ("the defense of *in pari delicto* loses its sting when the person who is *in pari*

delicto is eliminated." This court now rejects the defendants' *in pari delicto* argument for the same reason.

Conclusion

For the reasons stated herein, the defendants' motion to dismiss [Doc. No. 267] is hereby DENIED.

SO ORDERED, this 1st day of March, 2007.

/s/ Charles A. Pannell, Jr.
CHARLES A. PANNELL JR.
United States District Judge