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United States District Court,
N.D. Georgia, Atlanta Division.

S. Gregory HAYS, Receiver for Mobile Billboards of America, Inc.; California Mobile Billboards, et. al.; and Ronald Hallock; Ronald D. Reid; Alease Strickland by Kay L. Edgecombe, her attorney-in-fact; Douglas R. Ivester; and Barbara C. Ivester on behalf of themselves and a class of similarly situated persons, Plaintiffs,
v.
PAUL, HASTINGS, JANOFSKY & WALKER LLP, Defendant.

No. Civ.A. 106CV754-CAP.
|
Sept. 14, 2006.

Attorneys and Law Firms

Daniel S. Reinhardt, James David Dantzler, Jr., Thomas Ernest Borton, IV, Jaime L. Theriot, Troutman Sanders, LLP, Atlanta, GA, for Plaintiffs.

Elizabeth Vranicar Tanis, Dara L. Steele-Belkin, Jeremy U. Littlefield, John A. Chandler, Kristin Beth Wilhelm, Thomas W. Curvin, Sutherland, Asbill & Brennan, Atlanta, GA, for Defendant.

ORDER

PANNELL, J.

***1** This matter is before the court on the defendant's motion to dismiss [Doc. No. 12].

I. *Factual Background*

The following facts are derived from the complaint and construed in a light most favorable to the plaintiffs.

A. *The Investment Scheme*

Michael Lomas, Michael Young, and Laurinda Holohan are the sole shareholders of Mobile Billboards of America, Inc. ("MBA"), a corporation that offered mobile billboards as a "business opportunity." As part of its promotion and sales process, MBA provided potential purchasers with a disclosure statement describing the underlying business plan. In particular, potential investors were told that they could purchase a billboard unit for $20,000 and simultaneously lease the billboard back to Outdoor Media Industries ("OMI"), a company owned and operated by Lomas, Young, and Holohan, for a seven-year term. In exchange for leasing to OMI, potential investors were told that OMI would arrange for the placement of the billboard on a truck thereby generating advertising revenues for the potential investor of 13.49% per year.

OMI's advertising sales, however, did not generate sufficient revenue to make monthly lease payments to investors. Instead, OMI relied on money from new purchasers to make the earlier-promised lease payments. Thus, MBA's investment program operated as a Ponzi scheme.

In addition to 13.49% in advertising revenue per year, MBA agreed to repurchase the billboard at the end of the seven-year lease term for the full purchase price. Potential investors were told that MBA had established an independent trust, the Reserve Guaranty Trust ("RGT"), to assure that money would be available to fund this buy-back. Investors were assured that MBA deposited a portion of each billboard purchase price with RGT at the inception of the lease to create a sinking fund to support the buy-back.

RGT was not independent, however; it was controlled by Young and Holohan. Nor did MBA deposit any money into RGT.

Beginning in the spring of 2001, and continuing until August 2004, MBA sold mobile billboard units using the sales process described above to purchasers in North Carolina, Texas, and Georgia. In mid-2003, Lomas, Young, and Holohan formed California Mobile Billboards, Inc. ("CMBI") to begin selling mobile billboard units in California.

As a result of the sales material and other promotional activities engaged in by MBA and CMBI, billboard investments were sold to more than 1,000 investors.

Lomas, Young, and Holohan all had previcus experience offering "sale and leaseback" programs. Before forming MBA and CMBI, in the winter of 1998, Lomas formed National Payphone Company ("NPC") for the purpose of selling sale and leaseback rights in payphones. Both Young and Holohan worked with Lomas at NPC. By 2000, the United States Securities Exchange Commission ("SEC") had filed enforcement actions against payphone offerings similar to NPC. These events prompted Lomas to begin selling mobile billboards and form MBA and later CMBI. MBA and CMBI used the same sales structure that NPC had used.

B. *The Defendant's Involvement*

***2** As noted above, before 2002, MBA was selling mobile billboards in a number of states outside of California. Although MBA wished to sell billboards in California, it had been unable to get the investment qualified for sale in the State of California as a "business opportunity." Unlike securities offerings, "business opportunity" offerings are not generally registered with state and federal regulatory agencies. Thus, they are not usually subject to the rigorous regulatory review, approval, and registration process that securities offerings are.

Because Lomas's previous attorney was unable to convince California regulators that MBA's billboard investment was a "business opportunity," in July 2002, Lomas contacted the defendant, Paul, Hastings, Janofsky & Walker LLP ("Paul Hastings"), about representing MBA in connection with having the billboard offering approved as a "business opportunity" in California. In particular, Lomas contacted Michael Lindsey a partner located in Paul Hastings' Los Angeles office. Lindsey agreed to take on the representation and enlisted Josh Ridout, an associate in Paul Hastings' Los Angeles office, to work with MBA.

While Paul Hastings was initially retained by MBA for the purpose of having the offering approved for sale in California, the scope of Paul Hastings' representation immediately expanded to providing advice and counsel to MBA regarding investment offerings in states other than California. For example, Paul Hastings reviewed and revised the "offering circular" and sales materials for all of the billboard investments, provided advice about how the offering should be structured in California and other states, and reviewed and revised compliance materials provided to sales agents in various states. Although Paul Hastings reviewed the offering circular and other advertising material, this material did not note Paul Hastings' role in reviewing the documents or advising MBA or CMBI.

In addition to reviewing sales material, Paul Hastings suggested that MBA create CMBI for the purpose of selling mobile billboard units in California. After the formation of CMBI and due to revisions made to the offering materials and Paul Hastings' negotiations with regulators, CMBI's billboard offering was approved for sale as a "business opportunity" in California in April 2003. The complaint alleges, however, that MBA provided Paul Hastings with information which, if analyzed properly, would have shown that CMBI's billboard offering was, in fact, a security.

Despite being aware of facts indicating that the billboard investment was a security and not a "business opportunity," Paul Hastings did no meaningful diligence or investigation into MBA, CMBI, OMI, or RGT and did not consult a securities attorney. The complaint alleges that if Paul Hastings had investigated the business operations of MBA and CMBI, Paul Hastings would have discovered that MBA and CMBI were being operated as Ponzi schemes, [1] that RGT was not properly funded, and that the cost of the billboard frame being sold for $20,000 was actually less than $250.

***3** The complaint further alleges that Lindsey and Ridout had knowledge of material facts that were omitted from the offering circular and sales material for the billboard investments. For example, MBA provided financial projections to Paul Hastings that revealed that there was no

realistic way for MBA and CMBI to meet their financial obligations to investors. This information would have affected investors' purchase decisions. The complaint further alleges that Paul Hastings was aware that purchasers of billboard investments were relying on the offering circular and other sales materials reviewed by Paul Hastings.

C. *The Enforcement Actions*

On April 2, 2004, the North Carolina Securities Division filed an administrative proceeding in North Carolina against MBA and certain sales agents. On the same date, an administrative hearing officer determined that the MBA sale and leaseback program offered to North Carolina residents constituted the offer and sale of securities, not "business opportunities."

Also in 2004, Paul Hastings formed numerous limited liability companies and other entities at the direction of Lomas. Lomas immediately began transferring substantial amounts of money to these entities from MBA. The complaint alleges that Paul Hastings should have known that Lomas was using money derived from MBA to fund these other business ventures in direct conflict with his fiduciary duties as an officer and director of MBA and CMBI. [2]

By May 2004, MBA's financial condition had deteriorated significantly. In late May, Paul Hastings referred MBA and OMI to a law firm specializing in bankruptcy law.

On August 27, 2004, the SEC called Young, one of MBA's shareholders, and told him that it was investigating MBA and the billboard offering. Young contacted Lindsey, who then enlisted another Paul Hastings attorney, Walter Jospin, to deal with the SEC. Jospin, an experienced securities lawyer, determined that the billboard investment was a security and that MBA was operating a Ponzi scheme.

On September 21, 2004, the SEC filed an enforcement action in this district against MBA, Lomas, Young, and other affiliated entities, *SEC v. Mobile Billboards,* Civil Action No. 1:04-CV-2763. A consent order was immediately entered appointing Mr. Hays as the receiver for MBA. The district court later expanded the receivership to include CMBI.

D. *This Case*

This action was filed on March 31, 2006. The plaintiffs in this case are the court-appointed receiver for MBA/CMBI, Mr. Hays ("Receiver"), and Ronald Hallock, Ronald Reid, Alease Strickland, Douglas Ivester, and Barbara Ivester. Hallock, Reid, Strickland, and the Ivesters (collectively "Class Plaintiffs") all purchased mobile billboard investments developed, promoted, or sold by MBA and/or CMBI. The Class Plaintiffs seek to represent a class of purchasers of MBA and CMBI's mobile billboard investments. The potential class consists of more 1,000 members who invested more than $60 million.

***4** The complaint alleges eight state law causes of action related to Paul Hastings' conduct. Specifically, the Class Plaintiffs assert claims for negligence (Count I), aiding and abetting common law fraud (Count II), and civil conspiracy (Count III). The Receiver asserts claims for professional negligence (Count IV), breach of fiduciary duty (Count V), and aiding and abetting fraudulent conveyance (Count VI). The claims for punitive damages and litigation expenses (Counts VII and VIII) are asserted on behalf of both the Class Plaintiffs and the Receiver.

On May 30, 2006, Paul Hastings filed the present motion to dismiss arguing that each of the plaintiffs' eight claims should be dismissed under Georgia law. The plaintiffs oppose the motion contending that California law, not Georgia law, should control. Even if California law does not apply, the plaintiffs argue that the court should deny Paul Hastings' motion to dismiss.

II. *Legal Analysis*

A. *Choice-of-Law*

As an initial matter, the court must address what law to apply to the claims at issue in this case.

Federal courts sitting in diversity apply the forum state's choice-of-law rules. *Boardman Petroleum, Inc. v. Federated Mut. Ins. Co.,* 135 F.3d 750, 752 (11th Cir.1998). In tort cases, Georgia follows the traditional doctrine of *lex loci delicti. Dowis v. Mud Slingers, Inc.,* 279 Ga. 808, 816, 621 S.E.2d 413, 419 (2005). "The general rule is that 'the place of the wrong, the *locus delecti,* is the place where the injury was suffered rather than the place where the act was committed, or, as it is sometimes more generally put, it is the place where the last event necessary to make an actor liable for the alleged tort takes place." *Risdon Enterprises, Inc. v. Colemill Enterprises, Inc.,* 172 Ga.App. 902, 904, 324 S.E.2d 738, 740 (1984).

The parties disagree, however, as to where the plaintiffs' injury was suffered. The plaintiffs argue that all of the conduct giving rise to their tort claims occurred in California. For example, the plaintiffs point out that Lomas was a resident of California and orchestrated the Ponzi scheme from California. They also note that nearly all of Paul Hastings' legal work for MBA, Lomas, and affiliated entities was performed in California.

Paul Hastings, on the other hand, argues that the place where the injury was suffered is Georgia. With respect to the Class Plaintiffs' claims, two of the four named plaintiffs are residents of Georgia (Hallock and Reid). Thus, Paul Hastings contends that they suffered their injury in Georgia. Paul Hastings also argues that the Receiver, who steps into the shoes of MBA and CMBI, suffered its injuries in Georgia. According to Paul Hastings, MBA and CMBI suffered their losses when the SEC initiated an enforcement action against them in Georgia.

1. *The Class Plaintiffs*

The court concludes that Georgia law should apply to the claims brought by two of the named Class Plaintiffs, Mr. Hallock and Mr. Reid. As noted above, the Class Plaintiffs have asserted three independent causes of action against Paul Hastings: (1) negligence, (2) aiding and abetting fraud, and (3) civil conspiracy to conduct a fraudulent investment offering. The last act necessary to make an actor liable for each of these torts is damage to the Class Plaintiffs. Mr. Hallock and Mr. Reid are Georgia residents. Hallock and Reid did not suffer injury when Lomas decided to begin operating a Ponzi scheme or when Paul Hastings reviewed the offering circular. They suffered their injuries when they did not receive the benefits promised to them by MBA and CMBI. That injury was suffered in Georgia and they bore the economic impact of their losses in Georgia. Thus, Georgia law applies to their claims.

***5** The court cannot, however, determine what law should apply to the claims of the Ivesters and Ms. Strickland. The complaint does not allege where the Ivesters and Ms. Strickland reside, nor does it state where they purchased their mobile billboards. Because the complaint does not allege where the Ivesters or Ms. Strickland reside, the court cannot determine what law would apply to their claims. Accordingly, the plaintiffs are DIRECTED to show cause within 20 days from the date of this order why the court should not apply Georgia law to the Ivesters and Ms. Strickland's claims.

2. *The Receiver*

The court also concludes that Georgia law should apply to the claims brought by the Receiver. The Receiver has asserted claims for professional negligence, breach of fiduciary duty, and aiding and abetting fraudulent conveyances and breaches of fiduciary duty. The last event necessary to make Paul Hastings liable for these torts is injury to the Receiver. Because the Receiver stands in the shoes of MBA and CMBI, the court must look at where the injury to MBA and CMBI occurred. The injury to MBA and CMBI occurred when the SEC filed its enforcement action against them. The SEC's enforcement action was filed in Georgia. Accordingly, the court will apply Georgia law to the Receiver's claims.

3. *Due Process*

Although the rule of *lex loci delicti* compels the court to apply Georgia law to the majority of the plaintiffs' claims, citing *Philips Petroleum Co. v. Shutts,* 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), the plaintiffs argue that due process requires the court to apply California law to their claims. In support of this argument, the plaintiffs contend

that Georgia has no significant relationship with Paul Hastings' allegedly tortious conduct, while California's contacts are overwhelming. The plaintiffs also point out that California law differs significantly from Georgia law. For instance, the plaintiffs argue that Georgia common law does not recognize a claim for aiding and abetting breach of fiduciary duty, while California does. Finally, the plaintiffs contend that Paul Hastings' attorneys must have expected California law to govern their conduct.

The court disagrees with the plaintiffs. Due Process would not be violated by applying Georgia law to claims brought by Georgia residents who purchased mobile billboards in Georgia. Nor would due process be violated by applying Georgia law to claims brought by a Receiver who was appointed by a federal court sitting in Georgia pursuant to an SEC enforcement action that took place in Georgia. Although Lindsey and Ridout may have expected California law to govern their conduct, the plaintiffs' complaint alleges that MBA was selling mobile billboards pursuant to a Ponzi scheme in Georgia. The complaint further alleges that Lindsey and Ridout were aware of the fact that residents of other states were relying on the offering circular and advertising materials reviewed by Paul Hastings.

B. *Standard of Review for a Motion to Dismiss*

***6** Generally, a claim should be dismissed under Rule 12(b)(6) only where it appears beyond a doubt that the plaintiffs can prove no set of facts in support of their claim which would entitle them to relief. *Conley v. Gibson,* 355 U.S. 41, 45-46, 78 S.Ct. 99, 102, 2 L.Ed.2d 80 (1957). When considering a motion to dismiss, the court must accept the facts pled as true and construe them in a light favorable to the plaintiffs. *See Covad Communications Corp. v. BellSouth Corp.,* 299 F.3d 1272, 1279 (11th Cir.2002). Thus, Paul Hastings can succeed in its motion to dismiss only if accepting the facts pled in the complaint as true, it appears beyond a doubt that the plaintiffs can prove no set of facts in support of their claims.

C. *The Plaintiffs' Specific Claims*

Because the plaintiffs have not provided the court with enough information to determine what law should apply to the Ivesters and Ms. Strickland's claims, the following section will solely address the claims brought by Reid, Hallock, and the Receiver against Paul Hastings.

1. *Count One: Negligence*

The Class Plaintiffs first assert a negligence claim against Paul Hastings. In particular, the Class Plaintiffs allege that Paul Hastings authored, reviewed, revised, and approved the offering circular and other materials provided to potential investors. The complaint further claims that these materials failed to provide investors with material information, such as the actual cost of the billboards and the fact that RGT did not have sufficient assets to repurchase the billboards at the end of the lease period. The Class Plaintiffs allege that Paul Hastings knew that purchasers of billboard investments from MBA and CMBI would reasonably rely on their work product in drafting, reviewing, revising, and approving the offering circular and other materials.

Before 1983, the rule in Georgia was that absent intentional misrepresentation or fraud, a lawyer was not liable for negligence to a third party who was not in privity with that lawyer. *See Robert & Co. v. Rhodes-Haverty Partnership,* 250 Ga. 680, 300 S.E.2d 503 (1983). In 1983, however, the Supreme Court of Georgia in *Robert,* 250 Ga. 680, 300 S.E.2d 503, abandoned the privity requirement and adopted the rule enunciated in the Restatement (Second) of Torts § 552. Specifically, the *Robert* court extended professional liability for negligence to a foreseeable or limited class of persons for whom the information was intended, either directly or indirectly. *Id.*

A few years after *Robert,* the Northern District of Georgia decided the case of *Badische Corp. v. Caylor,* 630 F.Supp. 1196 (N.D.Ga.1986). In *Badische,* a company called Color-Dyne hired an accounting firm to prepare a financial statement. Color-Dyne then showed the financial statement to investors, who relied on the financial statement when deciding whether to extend and increase Color-Dyne's line of credit. After the investors

realized that the financial statement failed to reveal that various banks had secured interests in Color-Dyne's inventory, they sued the accounting firm for negligence pursuant to the rule set out in *Robert.* The district court granted the accounting firm's motion for summary judgment on the grounds that the duty of care imposed by the Restatement (Second) of Torts § 552 extends only to those persons whom the accountant actually knows will be given the information, as opposed to the persons whom the accountant should know will be supplied with the information. On appeal, the Eleventh Circuit certified the question of whether a third party can recover against an accountant under Georgia law for the accountant's negligence in preparing audited financial statements where it was foreseeable that the third party would rely on the financial statements. *Badische v. Caylor,* 806 F.2d 231 (1986). The Georgia Supreme Court answered the certified question in the negative, holding that professional liability extends only to those persons whom the professional is actually aware will rely upon the information the professional prepared. *Badische Corp. v. Caylor,* 257 Ga. 131, 133, 356 S.E.2d 198, 200 (1987).

***7** A decade after *Badische* was decided, the Georgia Court of Appeals again addressed the scope of a professional's liability to third parties in *Talton v. Arnall Golden Grecory, LLP,* 276 Ga.App. 21, 622 S.E.2d 589 (2005). The *Talton* decision dealt with the representation of Cryolife by Arnall Golden and Gregory ("AGG"). AGG was hired by Cryolife to consult about Cryolife's procedures for testing and treating cadaver tissue. AGG recommended that the corporation attach a warning label to its cadaver tissue packages stating that the tissue was not sterile and advising physicians to prescribe prophylatic antibiotics. Cryolife agreed and shipped the tissue to hospitals in packages that contained warning labels. The warning labels did not, however, refer to AGG.

In July 2003, a patient who received infected cadaver tissue supplied by Cryolife sued AGG for negligent misrepresentation claiming that AGG acted negligently when it recommended and prepared an inadequate warning label. The patient alleged that AGG knew that third parties, including patients, would rely on the warning label.

The Georgia Court of Appeals affirmed the trial court's dismissal of the patient's negligent misrepresentation claim against AGG. Pointing out that AGG was not identified on the warning label, that AGG supplied advice intended for use by Cryolife, and that AGG had no control over how Cryolife used the advice, the court held that AGG was not actually aware that patients would rely upon its confidential legal advice. Without such an awareness, the court concluded that AGG owed no duty to the patient.

Relying heavily on *Talton,* Paul Hastings argues that it was not actually aware that the Class Plaintiffs would rely on the offering circular and other advertising materials provided by MBA and CMBI. The Class Plaintiffs, on the other hand, argue that *Talton* is distinguishable because the warning label was directed to physicians and not patients.

The court views this case as very similar to *Talton.* Here, the complaint alleges that the information which caused the Class Plaintiffs' injuries was the content of MBA and CMBI's promotional materials, which were reviewed and drafted by Paul Hastings. Like *Talton,* it is undisputed that the offering circular and other promotional materials did not identify Paul Hastings in any way.[3] It is also undisputed that MBA and CMBI distributed the offering circular and promotional material to a large group of prospective investors. Due to the similarities between this case and *Talton,*[4] the court will dismiss Count One of the Complaint as to named plaintiffs Reid and Hallock.

2. *Count Two: Aiding and Abetting Fraud*

The Class Plaintiffs next assert a claim against Paul Hastings for aiding and abetting fraud. Specifically, the Class Plaintiffs allege that MBA and CMBI conducted a fraudulent investment offering and that Paul Hastings provided substantial assistance and encouragement in these allegedly fraudulent efforts.

***8** In its motion to dismiss, Paul Hastings argues that aiding and abetting fraud is not a recognized cause of action in Georgia. The Class Plaintiffs, on the other hand, point out that Georgia common law recognizes aiding and abetting liability for a variety of intentional torts. The Class Plaintiffs also argue that O.C.G.A. § 51-12-30 provides a statutory basis for the claim.

Neither party has directed the court to any Georgia case explicitly addressing the issue of whether Georgia recognizes a cause of action for aiding and abetting fraud. The court, moreover, has not located any case imposing liability on a party for aiding and abetting fraud under either the common law or pursuant to O.C.G.A. § 51-12-30. At most, the Georgia Court of Appeals in *R.W. Holdco, Inc. v. Johnson,* 267 Ga.App. 859, 865-66, 601 S.E.2d 177, 185 (2004), implicitly recognized the existence of such a cause of action. [5]

Since no Georgia court has explicitly recognized the tort of aiding and abetting fraud, the court will not do so now. Even assuming that Georgia courts will someday recognize a cause of action for aider and abettor liability in the context of fraud, the facts in this case do not warrant its creation now. [6] Thus, the court dismisses Count Two to the extent that it was brought by Reid and Hallock.

3. *Count Three: Civil Conspiracy*

Paul Hastings next moves to dismiss the Class Plaintiffs' civil conspiracy claim. In support of its motion, Paul Hastings argues that the Class Plaintiffs' claim fails because the Class Plaintiffs did not assert a fraud claim in this case. Paul Hastings also argues that the Class Plaintiffs have failed to satisfy Federal Rule of Civil Procedure 9(b). Specifically, Paul Hastings argues that the Class Plaintiffs have failed to allege that Paul Hastings received some benefit for participating in the scheme. Finally, Paul Hastings argues that the Class Plaintiffs' conspiracy claim fails because the Class Plaintiffs' claim essentially premises liability for conspiracy to commit fraud on allegations of mere negligence.

A conspiracy is a combination of two or more persons to accomplish an unlawful end by unlawful means. *Premier/Georgia Management Co., Inc. v. Realty Management Corp.,* 272 Ga.App. 780, 787, 613 S.E.2d 112, 118 (2005). To recover damages for civil conspiracy, a plaintiff must show that two or more persons, acting in concert, engaged in conduct that constitutes a tort. *Id.* Where civil liability for a conspiracy is sought to be imposed, the conspiracy itself furnishes no cause of action. Instead, the gist of the action is the underlying tort committed against the plaintiff and the damage done thereby. *Cook v. Robinson,* 216 Ga. 328, 329, 116 S.E.2d 742, 745 (1960). Accordingly, absent the underlying tort, there can be no liability for civil conspiracy. *Premier/Georgia Management,* 272 Ga.App. at 787, 613 S.E.2d at 118.

The Class Plaintiffs allege that Paul Hastings conspired with MBA and CMBI to defraud them. It is undisputed, however, that the Class Plaintiffs have not asserted a fraud claim in this action. Instead, the Class Plaintiffs rely on a fraud claim asserted by the SEC against MBA and CMBI in the enforcement action, Civil Action No. 1:04-CV-2763. Because no fraud claim has been asserted in this case, [7] the court dismisses Count Three of the Complaint to the extent that it is brought by Hallock and Reid.

4. *Count Four: Professional Negligence and Breach of Fiduciary Duty*

***9** Having addressed the Class Plaintiffs' claims, the court now turns to the three independent causes of action brought by the Receiver. The Receiver first asserts a professional negligence claim and a breach of fiduciary duty claim against Paul Hastings.

Paul Hastings makes two arguments in support of the dismissal of the Receiver's professional negligence and breach of fiduciary duty claims. First, Paul Hastings argues that these claims should be dismissed because the Receiver cannot show that MBA and CMBI's damages were proximately caused by Paul Hastings' alleged negligence. Specifically, Paul Hastings reads the Complaint as alleging that MBA and CMBI had

actual knowledge that the billboard investment was a security, thus, Paul Hastings' failure to properly advise MBA and CMBI that the billboard investment was a security did not cause MBA and CMBI's injury. Second, Paul Hastings argues that the Receiver's claims are barred by the equitable doctrine of *in pari delicto.* [8]

The Receiver, in response, first argues that causation is a factual issue that cannot be decided on a motion to dismiss. The Receiver contends that the Complaint adequately alleges facts sufficient to survive a motion to dismiss. For instance, the Receiver reads the Complaint as alleging that MBA and CMBI were interested in learning if the billboard investment was a security, and Paul Hastings' failure to inform MEA and CMBI that the investment was a security robbed them of the opportunity to adequately consider this issue. The Receiver further argues that Paul Hastings' error regarding the securities issue was not obvious to MBA and CMBI.

Regarding the doctrine of *in pari delicto,* the Receiver claims that the doctrine does not bar its recovery because corporate insiders, such as Lomas, and not the corporation itself benefitted from the alleged fraud. The Receiver also argues that its recovery would serve tort liability objectives by compensating victims of the wrongdoing and deterring future torts.

a. *Causation*

An essential element of both a claim for professional negligence and a claim for breach of fiduciary duty is that the defendant's breach of its duty proximately caused the plaintiff's damages. *See Dow Chemical Co. v. Ogletree, Deakins, Nash, Smoak & Stewart,* 237 Ga.App. 27, 514 S.E.2d 836, 837 (1999) (professional negligence); *Griffin v. Fowler,* 260 Ga.App. 443, 445, 579 S.E.2d 848, 850 (2003) (breach of fiduciary duty). Thus, in order to succeed on either of its claims, the Receiver must prove that MBA and CMBI's damages were proximately caused by Paul Hastings' breach.

The court concludes that the Receiver has adequately stated a claim for professional negligence and breach of fiduciary duty. The Complaint alleges that MBA and CMBI were concerned with whether the billboard investment was a security and asked Paul Hastings to research the issue for them. The Complaint also alleges that MBA and CMBI relied on Paul Hastings' review of the issue. While the Complaint does allege that Paul Hastings knowingly combined with MBA and CMBI to conduct a fraudulent investment offering, the court concludes that this allegation alone is not enough to warrant the dismissal of the Receiver's professional negligence and breach of fiduciary duty claims, especially in light of the allegations that MBA and CMBI asked Paul Hastings to advise them as to whether the investment was a security and then allegedly relied on Paul Hastings' advice (or lack thereof) regarding the security issue. Whether Paul Hastings' alleged negligence and breach of fiduciary duty are ultimately proved to be the proximate cause of MBA and CMBI's injuries is a fact question that is not appropriate for determination as a matter of law on a motion to dismiss. [9]

b. In Pari Delicto

***10** 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, "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 defendants:* 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, 86 L.Ed.2d 215 (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 question presented by the parties is whether Georgia courts would bar the Receiver from pursuing Paul Hastings for the (ultimate) benefit of

defrauded investors. If presented with the question, 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 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,* here Lomas, is eliminated from the suit and the recovery would ultimately go to innocent victims.

5. *Count Six: Aiding and Abetting Fraudulent Conveyance and Breaches of Fiduciary Duty*

The last claim asserted by the Receiver against Paul Hastings, Count Six, is alternatively titled "aiding and abetting fraudulent conveyances" and "aiding and abetting breach of fiduciary duty." In the claim, the Receiver argues that Lomas owed a fiduciary duty to MBA and CMBI and that he breached his fiduciary duty when he used MBA's assets for his own individual purposes. The complaint alleges that Paul Hastings aided and abetted Lomas's breach of fiduciary duty by providing Lomas with substantial assistance.

***11** Similar to the previous five claims, Paul Hastings argues that Count Six should be dismissed. Specifically, Paul Hastings argues that Georgia law does not recognize a claim for aiding and abetting breach of fiduciary duty. Similarly, although Paul Hastings admits that Georgia courts have not squarely addressed the issue of whether a cause of action for aiding and abetting fraudulent transfers exists when the aider-abetter is not a debtor or a transferee, Paul Hastings argues that Georgia courts would likely decline to recognize such a cause of action.

a. *Aiding and Abetting Breach of Fiduciary Duty*

On January 30, 2006, the Eleventh Circuit reiterated its conclusion that Georgia does not recognize a cause of action for aiding and abetting breach of fiduciary duty. *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards,* 437 F.3d 1145, 1157 (11th Cir.2006); *see also Munford, Inc. v. Valuation Research Corp.,* 98 F.3d 604, 613 (11th Cir.1996). Approximately six months later, on June 20, 2006, the Georgia Court of Appeals addressed the viability of a cause of action the plaintiff had denominated "aiding and abetting breach of fiduciary duty." *Insight Technology, Inc. v. Freightcheck, LLC,* No. A06A0710, 2006 WL 1679391, at *5-6 (Ga.Ct.App. June 20, 2006). The plaintiff in *Freightcheck,* Insight Technology, alleged that its president, Brewer, and a third party, Hull, secretly agreed to create a company to compete with Insight using Insight's computer software and business practices. Among other things, Insight asserted an aiding and abetting breach of fiduciary duty claim against Hull. The trial court granted Hull's motion for summary judgment on Insight's aiding and abetting breach of fiduciary duty claim after concluding that Georgia has never recognized a claim for aiding and abetting breach of fiduciary duty. The Georgia Court of Appeals reversed, holding that:

> [R]egardless of whether the claim is called "aiding and abetting a breach of fiduciary duty,' 'procuring a breach of fiduciary duty,' or 'tortious interference with a fiduciary relationship,' Georgia law authorizes a plaintiff to recover upon proof of the following elements: (1) through improper action or wrongful conduct and without privilege, the defendant acted to produce a breach of the primary wrongdoer's fiduciary duty to the plaintiff, (2) with knowledge that the primary wrongdoer owed the plaintiff a

> fiduciary duty, the defendant acted purposefully and with malice and intent to injure; (3) the defendant's wrongful conduct procured a breach of fiduciary duty; and (4) the defendant's tortious conduct proximately caused damage to the plaintiff.

Id. at *6. Based on the *Freightcheck* decision, the court concludes that Georgia does recognize a tort whose elements include procuring the breach of a fiduciary duty.

Although the Georgia Court of Appeals has now recognized a cause of action whose elements include procuring the breach of a fiduciary duty, the Receiver has failed to allege all of the elements of that tort. For example, the Receiver has not alleged that Paul Hastings acted with malice and with the intent to injure. Although the Receiver has failed to allege the essential elements of the *Freightcheck* tort, the court will not dismiss Count Six to the extent that it can be construed as a claim for procuring a breach of a fiduciary duty at this time. *See Corsello v. Lincare, Inc.,* 428 F.3d 1008, 1014 (11th Cir.2005) ("Ordinarily, a party must be given at least one opportunity to amend before the district court dismisses the complaint."). Instead, the Receiver is DIRECTED to file and serve an amended complaint within 20 days from the date of this order. The court expects that the amended complaint will correct the deficiencies pointed out in this order. If the amended complaint fails to correct the deficiencies pointed out in this order, Paul Hastings may renew its motion to dismiss Count Six.

b. *Aiding and Abetting Fraudulent Transfers*

***12** Georgia adopted the Uniform Fraudulent Transfer Act ("UFTA"), as codified at O.C.G.A. § 18-2-70, effective July 1, 2002. Although Georgia courts have not yet had an opportunity to address the issue of whether there is a cause of action for aiding and abetting a fraudulent transfer when the alleged aider-abetter is not a debtor or a transferee, the court concludes that Georgia courts are not likely to recognize such an action. UFTA does not refer to parties other than debtors, creditors, and transferees. There is no language in UFTA that suggests the creation of a distinct cause of action for aiding and abetting claims against non-transferees. The court concludes that to allow claims to be brought against non-transferees, such as Paul Hastings, would expand UFTA beyond its facial application and in a manner that is outside the purpose and plain language of the statute. Because Paul Hastings is not a debtor or a transferee, the court will dismiss Count Six to the extent it can be construed as a claim for aiding and abetting fraudulent transfers.

6. *Counts Seven and Eight: Punitive Damages and Costs*

Counts Seven and Eight are dependent on the viability of the previous six counts. Paul Hastings argues that Count Seven should be dismissed because punitive damages are unavailable absent a valid claim for actual damages. Similarly, Paul Hastings argues that Count Eight should be dismissed because costs and attorney's fees are not recoverable unless damages are awarded on a prevailing claim.

Because the court has dismissed Counts One, Two, and Three, the only claims brought by Reid and Hallock, the court must dismiss Counts Seven and Eight as to Reid and Hallock. On the other hand, because the court has not dismissed Counts Four, Five, and Six of the Complaint, the court will not dismiss Counts Seven and Eight to the extent that they were brought by the Receiver.

III. *Conclusion*

For the reasons discussed above, the court GRANTS IN PART and DENIES IN PART Paul Hastings' motion to dismiss [Doc. No. 12]. Specifically, the court DISMISSES Counts One, Two, Three, Seven, and Eight to the extent that they were brought by Class Plaintiffs Reid and Hallock. The plaintiffs are DIRECTED to show cause within 20 days from the date of this order why the court should not apply Georgia law to the claims brought by the Ivesters and Ms. Strickland. The court also dismisses Count Six of the Complaint to the extent it alleges a claim for aiding and abetting fraudulent transfers. To the extent that Count Six attempts to allege a cause of action for procuring the breach of a fiduciary duty, as set out in *Freightcheck,* 280

Ga.App. 19, 633 S.E.2d 373, 2006 WL 1679391 at *6, the Receiver is DIRECTED to file and serve an amended complaint within 20 days from the date of this order. The court expects that the amended complaint will correct the deficiencies pointed out in this order. If the amended complaint fails to correct the deficiencies pointed out in this order, Paul Hastings may renew its motion to dismiss Count Six. Paul Hastings' motion to dismiss [Doc. No. 12] is otherwise DENIED.

***13** SO ORDERED.

All Citations

Not Reported in F.Supp.2d, 2006 WL 4448809

Footnotes

1 For example, purchase money paid by new investors was used to fund lease payments to earlier investors.

2 In addition to creating limited liability companies, Lindsey enlisted Jeff Geida, another Paul Hastings associate, to assist Lomas in estate planning designed to protect his assets from creditors.

3 Thus, the offering circular was presented to potential investors as a representation from MBA and CMBI, not from Paul Hastings.

4 Although the warning label in *Talton* was directed to doctors and not patients, this was not the stated basis of the Georgia Court of Appeals' decision.

5 In *Holdco,* a corporate plaintiff asserted a claim for aiding and abetting fraud against the law firm and the accounting firm that represented it during the sale of certain corporate assets. The plaintiff alleged that the sale of corporate assets was unauthorized and that the firms suppressed facts regarding the allegedly unauthorized sale. The Georgia Court of Appeals affirmed the trial court's grant of summary judgment to the professional firms on the grounds that the corporation had clothed the officer who "authorized" the deal with apparent authority to conduct business on behalf of the corporation.

6 Assuming arguendo that Georgia did recognize such a claim, to establish liability for aiding and abetting fraud, the Class Plaintiffs would have to show: (1) the existence of a fraud, (2) Paul Hastings' knowledge of the fraud, and (3) that Paul Hastings provided substantial assistance to advance the fraud's commission. *See ZP No. 54 Limited Partnership v. Fidelity and Deposit Co. of Maryland,* 917 So.2d 368, 372 (Fla.Dist.Ct.App.2005) ("Virtually all courts that have acknowledged the existence of aiding and abetting a fraud state that the following are the elements that must be established by the plaintiff: (1)[t]here existed an underlying fraud, (2)[t]he defendant had knowledge of the fraud, [and] (3) [t]he defendant provided substantial assistance to advance the commission of the fraud."). However, aiding and abetting requires actual knowledge and is not satisfied by reckless or negligent conduct. *See JP Morgan Chase Bank v. Winnick,* 406 F.Supp.2d 247, 253 n. 4 (S.D.N.Y.2005) ("[T]he weight of the case law, cited above, defines knowledge in the context of an aiding and abetting claim as actual knowledge."); *see also Sender v. Mann,* 423 F.Supp.2d 1155, 1176 (D.Colo.2006). Although the complaint alleges that Paul Hastings "knew or should have known" that MBA and CMBI were conducting a fraudulent investment offering, the facts set out in the complaint do not support Paul Hastings' actual knowledge of the fraud. At most, they suggest that Paul Hastings was provided with sufficient information to discover the fraud if they had consulted a securities lawyer or conducted the appropriate due diligence.

7 Neither party has cited the court to any case allowing the underlying tort claim to be split from the conspiracy claim.

8 As discussed in more detail later, the of *in pari delicto* 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).

9 In its reply brief, Paul Hastings argues for the first time that the collapse of the Ponzi scheme is not attributable to Paul Hastings' failure to advise MBA and CMBI that the billboard investment was a security. Because the Receiver has not had an opportunity to respond to this argument, the court will not address it in this order. The court notes, however, that there are several types of damages claimed by the Receiver. For example, the Receiver complains that Paul Hastings' failure to advise MBA and CMBI that the offering was a security caused the SEC to institute an enforcement action against MBA and CMBI. Thus, even assuming the

collapse of the Ponzi scheme could not be attributed to Paul Hastings, the Receiver's allegations regarding the SEC enforcement action certainly would be enough to survive a motion to dismiss.

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