UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 10-50494
	)	
FAIR FINANCE COMPANY,	)	Chapter 7
	)	
Debtor.	)	Chief Judge Pat E. Morgenstern-Clarren
	)	
_____	)	
	)	
BRIAN A. BASH, TRUSTEE,	)	Case No. 5:13-cv-2098
	)	Judge Patricia A. Gaughan
Plaintiff,	)	
	)	Adversary Proceeding No. 10-5038
v.	)	Chief Judge Pat E. Morgenstern-Clarren
	)	
FAIR FINANCE COMPANY, *et al.,*	)	**REPORT AND RECOMMENDATION**
	)	**TO DENY JOHN HEAD'S MOTION**
Defendants.	)	**FOR SUMMARY JUDGMENT**

Fair Finance Company, started in 1934 as a legitimate business, enjoyed financial success for many years before being sold in 2002 to Fair Holdings, Inc., an entity created and controlled by James Cochran and Timothy Durham. Fair Finance stopped operating in 2009 when the Federal Bureau of Investigation seized its computers and records, and it ended up as a chapter 7 debtor in 2010. Cochran, Durham, and Chief Financial Officer Rick Snow were later convicted of federal securities and wire fraud, as well as conspiracy to commit those crimes.

John Head served as Fair Finance's President from 2004 to January 2009. The chapter 7 trustee Brian Bash, alleging that Cochran, Durham, Head, Snow, and others ran the business

fraudulently, brought claims against several companies and individuals, including Head.[1]

Head, who denies any involvement in the alleged fraud, now moves for summary judgment on the cross-claim filed against him.[2] The trustee opposes the motion.[3] For the reasons stated below, this court recommends that the district court deny the motion because there are genuine issues of material fact as to Head's involvement in the fraudulent activities.

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[1] The pleadings are in an unusual posture due to the fact that the litigation started in state court and was removed by the trustee to federal court. After removal, the predecessor bankruptcy judge dismissed the original plaintiffs at their request, granted a motion to substitute the trustee for then-defendant Fair Finance Company, and re-aligned the parties to have the trustee be the plaintiff. Because the trustee filed his claims before the re-alignment, they appear on the docket as cross-claims made by one defendant (the trustee) against another (Head). (Docket 17). All footnote citations just to "docket" are to the bankruptcy court docket in adversary proceeding 10-5038.

[2] District Court case 5:13-cv-2098, docket 32, 33, 48.

[3] District Court case 5:13-cv-2098, docket 43.

I. JURISDICTION

United States District Court for the Northern District of Ohio General Order 2012-7 refers all cases under title 11 and all proceedings arising under or arising in or related to a case under chapter 11 to the bankruptcy judges for this district. The Hon. Patricia A. Gaughan withdrew the reference of the captioned adversary proceeding and then re-referred it to the bankruptcy court for pretrial supervision, including providing a Report and Recommendation on dispositive motions, such as this one.[4] This court submits the Report and Recommendation under Federal Rule of Bankruptcy Procedure 9033(a) and the authority of *Executive Benefits*

[4] Docket 287, 290.

Insur. Agency v. Arkison, 134 S.Ct. 2165 (2014). Although Bankruptcy Rule 9033(a) directs the bankruptcy court to file proposed findings of fact and conclusions of law in non-core proceedings, this court is precluded from submitting proposed findings of fact based on the law applicable to motions for summary judgment.

II. THE FEDERAL RULES OF BANKRUPTCY PROCEDURE APPLY[5]

The Federal Rules of Bankruptcy Procedure apply in all cases under title 11, whether the matter is being heard by the district court or the bankruptcy court. *See* FED. R. BANKR. P. 1001; FED. R. CIV. P. 81(a)(2); *see also Owens-Illinois, Inc. v. Rapid Am. Corp. (In re Celotex Corp.)*, 124 F.3d 619, 629-30 (4th Cir. 1997) (citing Bankruptcy Rule 1001 and noting that the entire body of the Bankruptcy Rules apply to the extent a matter is before a district court under § 1334(b)); *Phar-Mor, Inc. v. Coopers & Lybrand*, 22 F.3d 1228, 1236-37 (3d Cir. 1994) (same); *Diamond Mortgage Corp. of Ill. v. Sugar*, 913 F.2d 1233, 1240-41 (7th Cir. 1990) (same). Therefore, the Bankruptcy Rules govern in this proceeding regardless of the withdrawal and re-referral of the reference for a specific purpose.

III. UNDISPUTED BACKGROUND INFORMATION[6]

Donald Fair's father founded Fair Finance Company (Fair Finance, debtor or company) in 1934. The company made direct consumer loans and also did used car financing. Fair

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[5] The Federal Rules of Civil Procedure will be referred to in the text as the Civil Rules and the Federal Rules of Bankruptcy Procedure will be referred to as the Bankruptcy Rules.

[6] *See* statements in the briefs, Stipulations of Fact by and among the trustee, Head, and co-defendant Keith Schaffter (docket 167), Second Stipulations of Fact between the trustee and Head (docket 271), testimony of Donald Fair and Douglas DeRose in *United States of America v. Durham, et al.*, case 1:11-CR-00042 (S.D. Ind.) filed in District Court case 5:13-cv-2098, (docket 26), and the claims register in the main bankruptcy case, *In re Fair Finance Company*, case 10-50494.

Finance funded its operations in part by selling investment certificates (V-Notes) to Ohio residents through private placements. Under this program, a buyer paid a lump sum to Fair Finance in exchange for an agreement that Fair Finance would pay interest at agreed-upon rates at stated intervals and that when the V-Note matured the principal would be returned to the buyer. The interest rates and maturity times varied over the years.

Under Ohio law, Fair Finance had to register each securities offering with the Ohio Division of Securities before offering the V-Notes for sale.[7] Each offering was limited in amount and time. The registration materials included an offering circular with attached financial statements. The division did not, however, approve or disapprove any offering circular.

Donald Fair took over the business in the 1960s. In the 1980s, he changed the focus of the business to financing consumer contracts for third-party businesses. The company continued to sell V-Notes.

James Cochran and Timothy Durham purchased Fair Finance in 2002 through Fair Holdings Inc., a company formed for that purpose. Fair Holdings Inc. is in turn owned by DC Investments, LLC. Cochran and Durham are the sole members of DC Investments, LLC.

At the time of the purchase, John Head was a long time Fair Finance employee, having begun in 1986 as a collection manager and worked his way up to Vice President and Director of Operations by 1994 or 1995. He remained with Fair Finance after the sale, reporting throughout his tenure to Durham and Cochran. Durham and Cochran promoted him to President in 2004. Head continued as President until December 2008, when he resigned effective January 7, 2009. He did consulting work for Fair Finance in the months that followed.

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[7] *See* OHIO REV. CODE §§ 1707.01-1707.99.

Fair Finance's creditors have filed more than $23 million in claims. The creditors include individuals (and trusts for the benefit of individuals) who purchased V-Notes.

IV. THE CROSS-CLAIM

The chapter 7 trustee asserts multiple claims against multiple parties in this adversary proceeding. Count 7, the only cross-claim asserted against Head, is for civil conspiracy to commit fraud. In it, the trustee alleges that Head and other named defendants (including Durham, Cochran, Daniel Laikin, Jeffrey Eglen, Keith Schaffter, and Snow)[8] had a common understanding or design with Durham and Cochran to commit fraud upon the debtor and the individuals who purchased V-Notes. He further alleges that all of these defendants acted purposefully without a reasonable or lawful excuse, which resulted in injury and damages to Fair Finance and its investors in excess of $200,000,000.00.

V. THE SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate if the movant "shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a) (made applicable by FED. R. BANKR. P. 7056). The determination as to whether a factual issue is genuine "necessarily implicates the substantive evidentiary standard of proof that would apply at the trial on the merits." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986). The moving party bears the initial burden of production. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). "After the moving party has met its burden, the burden shifts to the nonmoving party,

[8] After defendants DC Investments, LLC and Fair Holdings Inc. agreed to assign their assets to the trustee, he dismissed his claims against them. Main bankruptcy case 10-50494, docket 188. He also dismissed defendants Obsidian Enterprises, Inc. and Fair Facility I, LLC. Docket 251. The trustee recently settled his claim against Snow. Main bankruptcy case 10-50494, docket 1458.

who must present some 'specific facts showing that there is a genuine issue for trial.'" *Jakubowski v. Christ Hosp., Inc.*, 627 F.3d 195, 200 (6th Cir. 2010) (quoting *Anderson*, 477 U.S. at 248). "[I]f the nonmoving party fails to make a sufficient showing on an essential element of the case with respect to which the nonmovant has the burden, the moving party is entitled to summary judgment as a matter of law." *Thompson v. Ashe*, 250 F.3d 399, 405 (6th Cir. 2001).

All of the facts and the reasonable inferences drawn from those facts must be considered in the light most favorable to the non-moving party. *City Mgmt. Corp. v. U.S. Chem. Co.*, 43 F.3d 244, 250 (6th Cir. 1994). "[A] 'judge's function' at summary judgment is not 'to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial.'" *Tolan v. Cotton*, 134 S.Ct 1861, 1866 (2014) (per curium) (quoting *Anderson,* 477 U.S. at 249). "However, if 'the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no genuine issue for trial.'" *Vaughn v. Lawrenceburg Power Sys.*, 269 F.3d 703, 710 (6th Cir. 2001) (quoting *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587(1986)).

VI. THE POSITIONS OF THE PARTIES

Head argues that the trustee cannot prove all of the elements of the underlying fraud claim and that, even if he could, he cannot prove that Head participated in a conspiracy to commit that fraud. Head contends that the evidence shows that any fraud that was committed was done by individuals in the Indianapolis office, while he was located in Akron and involved only in the legitimate business of consumer receivables financing. Additionally, he maintains that there is no evidence that he conspired with anyone to commit fraud. Head concludes that there are no genuine issues of material fact and he is entitled to judgment as a matter of law.

The trustee makes a two-step argument against Head's motion.[9] Step one: Cochran, Durham, Head, Snow, and others defrauded V-Note buyers by making material misrepresentations in the offering circulars, including representations in the attached financial statements and in the repeated representation that Fair Finance was continuing to follow its "traditional business plan and or business procedures;"[10] i.e., the long-time conservative one in place before Donald Fair sold the company to Cochran and Durham. In truth, the argument goes, the post-sale Fair Finance engaged in fewer and fewer traditional consumer finance transactions and instead used its money to make more and more risky loans to related parties. As a result, the percentage of the company's assets devoted to the traditional business fell, while the percentage devoted to related party loans rose. The argument continues that Cochran, Durham, and their co-conspirators intended for the V-Note buyers to rely on the misrepresentations and that they did so, to their financial detriment. Step two: when the fraudulent V-Note offerings brought in funds, Cochran, Durham, Head, and others conspired to strip the money out of Fair Finance through related party loans, with Head receiving (or expecting to receive) large amounts of money through a false Fair Holdings "salary" and a phantom stock plan for the part he played in running the consumer receivables financing operation. Some time into the scheme, Fair Finance reached a financial point where it could only redeem matured V-Notes if it brought in money from new buyers. This ultimately resulted in Fair Finance being unable to pay its creditors, including those whose V-Notes were outstanding at the time of the bankruptcy filing and others unconnected to the V-Notes.

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[9] Trustee Response, District Court case 5:13-cv-2098, docket 43 at 3-5.

[10] *See, for example,* docket 186.

Head argues that the trustee lacks standing to raise this claim because he is bringing the claim on behalf of the third-party V-Note buyers, rather than Fair Finance itself. Alternatively, he argues that the claim is barred by the doctrine of *in pari delicto* (in equal fault) and also should be dismissed because it fails to state a fraud claim with the requisite particularity under Civil Rule 9(b). All else failing, he moves for judgment on the ground that the trustee cannot prove one element of his fraud claim–that the V-Note buyers relied on the alleged misrepresentations in the offering circulars–and also because he cannot prove that Head conspired with others to perpetrate the alleged fraud against Fair Finance. In connection with these positions, he argues that certain of the evidence offered by the trustee should be excluded.

The trustee responds that he has standing because he is bringing the claim on behalf of the debtor to recover for the damage it suffered when the defendants stripped its assets. As to the *in pari delicto* issue, his position is that the doctrine does not apply to bar claims against corporate insiders such as Head. On the Civil Rule 9(b) issue, he argues that the issue has been waived, ruled on, or otherwise lacks merit. Finally, he contends that all of his evidence should be considered and that there is a genuine issue of material fact which precludes granting the motion.

Additional arguments are set forth under the relevant parts of the discussion.

VII. DISCUSSION

A. Civil Conspiracy to Commit Fraud

The trustee brings his claim against Head for civil conspiracy under Ohio law. Ohio defines the cause of action "as a malicious combination of two or more persons to injure another person or property, in a way not competent for one alone, resulting in actual damages." *Kenty v.*

Transamerica Premium Ins. Co., 72 Ohio St.3d 415, 650 N.E.2d 863, 866 (Ohio 1995) (internal quotation marks and citations omitted). Stated somewhat differently, the elements of a civil conspiracy are: "(1) a malicious combination; (2) two or more persons; (3) injury to person or property; and (4) existence of an unlawful act independent from the actual conspiracy." *Lee v. Countrywide Home Loans, Inc.*, 692 F.3d 442, 446 (6th Cir. 2012) (discussing Ohio law) (quotation marks and citation omitted). An underlying unlawful act must be committed before a civil conspiracy action can be maintained. *Orbit Elec., Inc., v. Helm Instrument Co.*, 167 Ohio App.3d 301, 855 N.E.2d 91, 100 (Ohio Ct. App. 2006).

"The element of 'malicious combination to injure' does not require a showing of an express agreement between defendants, but only a common understanding or design, even if tacit, to commit an unlawful act." *Gosden v. Louis*, 116 Ohio App.3d 195, 687 N.E.2d 481, 496 (Ohio Ct. App. 1996). "With respect to the level of agreement that must be established . . . '[a]ll that must be shown is that . . . the alleged coconspirator shared in the general conspiratorial objective. . . .'" *Aetna Cas. & Surety Co. v. Leahey Constr. Co.*, 219 F.3d 519, 538 (6th Cir. 2000) (quoting *Hooks v. Hooks*, 771 F.2d 935, 944 (6th Cir. 1985)). The existence of an agreement "is nearly always established by circumstantial evidence, as conspirators seldom make records of their illegal agreements." *United States v. Short*, 671 F.2d 178, 182 (6th Cir. 1982). "The malice involved in the tort is that state of mind under which a person does a wrongful act purposely, without a reasonable or lawful excuse, to the injury of another." *Williams v. Aetna Fin. Co.*, 83 Ohio St.3d 464, 700 N.E.2d 859, 868 (Ohio 1998) (quotation marks and citation omitted).

The trustee identifies the required underlying unlawful act in this case as fraud in the sale of the V-Notes. Under Ohio law, the elements of fraud are:

> (a) a representation or, where there is a duty to disclose, a concealment of a fact, (b) which is material to the transaction at hand, (c) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (d) with the intent of misleading another into relying upon it, (e) justifiable reliance upon the representation or concealment, and (f) a resulting injury proximately caused by the reliance.

Gaines v. Preterm-Cleveland, Inc., 33 Ohio St.3d 54, 514 N.E.2d 709, 712 (Ohio 1987). At trial, the trustee must prove his case by a preponderance of the evidence. *Household Fin. Corp. v. Altenberg*, 5 Ohio St.2d 190, 214 N.E.2d 667, syllabus (Ohio 1966).

B. Standing

The first issue is whether the trustee has standing to bring the civil conspiracy claim against Head. Head argues that these claims are really for fraud committed against the V-Note buyers. The trustee responds that he brings the claims for fraud committed against Fair Finance, a cause of action that belongs to the debtor.

Standing is a jurisdictional issue which involves both constitutional and prudential limitations. *McGlone v. Bell*, 681 F.3d 718, 728 (6th Cir. 2012). The trustee, as the party invoking jurisdiction, has the burden of establishing standing. On that issue, as well as others at the summary judgment stage, the trustee "can no longer rest on . . . 'mere allegations,' but must 'set forth' by affidavit or other evidence 'specific facts.'" *Clapper v. Amnesty Int'l USA*, 133 S.Ct. 1138, 1148-49 (2013) (quoting *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561 (1992)).

The constitutional limitation of standing stems from the "case or controversy" requirement of Article III of the United States Constitution. U.S. CONST. art. III, § 2, cl.1.

"The doctrine of standing gives meaning to these constitutional limits by 'identify[ing] those disputes which are appropriately resolved through the judicial process.'" *Susan B. Anthony List v. Driehaus*, 134 S.Ct. 2334, 2341 (2014) (quoting *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992)). To meet this limitation, a plaintiff must show that: (1) he has suffered an injury-in-fact which is concrete, particularized, and actual or imminent, rather than conjectural or hypothetical; (2) the injury is fairly traceable to the challenged action of the defendant; and (3) it is likely rather than merely speculative that the injury will be redressed by a favorable decision. *LPP Mortg., Ltd. v. Brinely*, 547 F.3d 643, 647-48 (6th Cir. 2008). Head does not dispute that the trustee meets the constitutional limits.

Head's challenge addresses the prudential limitation of standing because he claims that the trustee is trying to vindicate rights that belong to the third-party V-Note buyers. To meet this judge-made limitation of standing, a plaintiff must: (1) assert his own legal rights rather than the legal rights or interests of third parties; (2) assert more than a generalized grievance that is shared by a large class of citizens; and (3) in statutory cases, fall within the "zone of interests" regulated by the statute in issue. *Coal Operators & Assocs., Inc. v. Babbitt*, 291 F.3d 912, 916 (6th Cir. 2002). These requirements "enforce the principle that 'the plaintiff must be a proper proponent, and the action a proper vehicle, to vindicate the rights asserted.'" *Id.* at 916 (quoting *Pestrak v. Ohio Elections Comm'n*, 926 F.2d 573, 576 (6th Cir. 1991)).

The prudential principles of standing and the chapter 7 trustee's powers under the Bankruptcy Code are "coextensive." *Stevenson v. J.C. Bradford & Co. (In re Cannon)*, 277 F.3d 838, 853 (6th Cir. 2002) (citing *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 118 (2d Cir. 1991)). The trustee, as a creature of statute, has only those powers given to him by the

Bankruptcy Code. *Id.* Bankruptcy Code § 704 grants a chapter 7 trustee authority to collect property of the estate and reduce it to money. 11 U.S.C. § 704(a)(1). Estate property includes causes of action belonging to the debtor. *Stevenson*, 277 F.3d at 853. Therefore, a "trustee stands in the shoes of the debtor and has standing to bring any action that the [debtor] could have brought had [it] not filed a petition for bankruptcy." *Id.* On the other hand, "[i]f a cause of action belongs solely to the estate's creditors . . . then the trustee has no standing to pursue the claim." *Id.; see also Caplin v. Marine Midland Grace Trust Co. of N.Y.*, 406 U.S. 416, 434 (1972) (stating that a trustee in bankruptcy does not have standing to pursue the claims of creditors against third parties); *Terlecky v. Hurd (In re Dublin Sec., Inc.)*, 133 F.3d 377, 379-80 (6th Cir. 1997) (same). Whether a cause of action is available to the debtor and, therefore, constitutes property of the estate is governed by state law. *Spartan Tube & Steel, Inc. v. Himmelspach (In re RCS Engineered Prods. Co.)*, 102 F.3d 223, 225 (6th Cir. 1996) (citing *Butner v. United States*, 440 U.S. 48 (1979)).

The inquiry, then, is this: is the trustee raising a claim that the V-Note buyers have against Head under Ohio law and for which he seeks to recover damages incurred by them or is the trustee raising a claim that Fair Finance has against Head under Ohio law and for which he seeks to recover damages incurred by Fair Finance? If the former, the trustee lacks standing. If the latter, the trustee has standing.

As stated above, at this point in the proceedings the arguments and analysis should normally focus on evidence rather than allegations in the pleadings. In this case, however, Head in raising the issue argues only that the language of the cross-claim shows that the trustee lacks standing and the trustee responds in kind. The court will do the same.

Head argues that the trustee is not asserting the debtor's claim as shown by the trustee's cross-claim, paragraphs 23 to 24.[11] Those paragraphs allege that the V-Note buyers relied on certain representations that were false, omitted important facts, or were designed to defraud them.

The trustee in opposition cites to allegations in the cross-claim that both the V-Note buyers *and* Fair Finance were damaged by the fraudulent actions and conspiracy of Durham, Cochran, Head, and others. *See* paragraphs 27, 73, and 74. These paragraphs allege that the defendants' actions were unlawful, causing loss to the investors "and loss of the assets of the Debtor, resulting in an insolvent estate and diminished funds from which to pay creditors of the Debtor;" that the defendants had a "common understanding or design with . . . Durham and . . . Cochran to commit fraud upon [the debtor] and its investors;" and that the defendants "acted purposefully without a reasonable or lawful excuse resulting in injury and damages to Fair and its investors in excess of $200,000,000." Count 7 alleges that the defendants damaged Fair Finance through their actions and that Fair Finance seeks to recover those damages.

Reading the cross-claim as a whole, the trustee is raising a claim against Head that he and others injured Fair Finance's corporate worth through their civil conspiracy to commit fraud. While there are indeed references to the V-Note buyers, they are necessary to give context to the direct claim made by Fair Finance. This is because the trustee argues that the first step in the alleged conspiracy was to bring in new buyers for the V-Notes through misrepresentations; those buyers provided funds that were then stripped out of Fair Finance for the personal benefit of the

[11] Head Memorandum (Mem.), District Court case 5:13-cv-2098, docket 33 at 7.

conspirators. Again according to the trustee, when the scheme unraveled because the pool of buyers dried up, Fair Finance was insolvent and unable to pay its creditors.

Significantly, Ohio law provides that a claim for fraud against the corporation, including a claim against corporate directors and officers, belongs to the corporation. *See Adair v. Wozniak*, 23 Ohio St.3d 174, 492 N.E.2d 426, 428 (Ohio 1986) ("It is well-settled that only a corporation and not its shareholders can complain of an injury sustained by, or a wrong done to, the corporation."); *Grand Council of Ohio v. Owens*, 86 Ohio App.3d 215, 620 N.E.2d 234, 238 (Ohio Ct. App. 1993) (noting that claims for corporate mismanagement, waste, negligence, and a breach of fiduciary duty are generally actions which belong to the corporation itself). Thus, only Fair Finance can raise this claim and the trustee, standing in Fair Finance's shoes, has standing to do so.

In arguing for a different result, Head relies in his reply brief on *Picard v. JP Morgan Chase & Co.*, 460 B.R. 84 (S.D. N.Y. 2011) decided under New York law.[12] That case, together with a companion case, was decided on appeal at 721 F.3d 54 (2d Cir. 2013); this court will consider that opinion rather than the trial court opinion cited. There is, however, no need to go into great detail in analyzing Head's argument because it is apparent that the case is not relevant.

The *Picard* trustee raised two sets of claims against third parties: one asserted by him as trustee and the other admittedly asserted on behalf of customers. Both district courts dismissed all claims, holding that the trustee lacked standing. The Second Circuit first considered whether the trustee had jurisprudential standing to raise his own claims. At the outset, the Circuit noted that state law determines whether a cause of action belongs to a debtor or to the creditors. 721

[12] Head Reply, District Court case 5:13-cv-2098, docket 48 at 2.

F.3d at 63 n.10. The Circuit went on to quote the applicable New York law that "[a] 'claim against a third party for defrauding a corporation with the cooperation of management accrues to creditors, not to the guilty corporation.'" *Id.* at 63 (quoting *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 120 (2d Cir. 1991)). In this case, Ohio law governs and Ohio law provides that the stated cause of action belongs to the debtor.

Also, the long-standing Second Circuit analysis conflates the standing issue with the defense of *in pari delicto* which, as discussed below, the Sixth Circuit does not. *See Unencumbered Assets, Trust v. JP Morgan Chase Bank (In re Nat'l Century Fin. Enter., Inc., Investment Litig.),* 617 F. Supp.2d 700, 711 (S.D. Ohio 2009). When the Second Circuit went on to consider whether the trustee had standing to assert claims admittedly belonging to third-parties, it found that he did not. The issue here is quite different because the trustee asserts he raises his own claims, not those of the V-Note buyers. All in all, the *Picard* opinion does not require or support a different result than the one recommended here.

C. ***In Pari Delicto***

Head argues alternatively that the equitable doctrine of *in pari delicto* prevents the trustee from bringing the civil conspiracy claim against him as a matter of law. "'*In pari delicto*' means 'in equal fault.'" *Bash v. Textron Fin. Corp.*, 483 B.R. 630, 650 (N.D. Ohio 2012) (quoting *Pinter v. Dahl*, 486 U.S. 622, 632 (1988)). The doctrine "refers to the plaintiff's participation in the same wrongdoing as the defendant." *Terlecky*, 133 F.3d at 380 (quotation marks and citation omitted). It "prevents a party from recovering for its own wrongful acts, because no court will lend aid to one who acted illegally itself." *Textron Fin. Corp.*, 483 B.R. at 650. The doctrine is a defense under Ohio common law. *See Jones v. Hyatt Legal Servs. (In re Dow)*, 132 B.R. 853,

860 (Bankr. S.D. Ohio 1991) (discussing Ohio law on this issue). In the Sixth Circuit, the *in pari delicto* defense can be raised against a bankruptcy trustee pursuing a debtor's cause of action to the same extent that the defense could have been raised against the debtor. *Terlecky*, 133 F.3d at 380–81.

Head raises this argument as part of his contention that the trustee lacks standing. The general view, however–and the one followed in the Sixth Circuit–is that "[a]n analysis of standing does not include an analysis of equitable defenses, such as *in pari delicto*." *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 346 (3d Cir. 2001). The equitable defense should, instead, be addressed separately. *See Terlecky,* 133 F.3d at 380 (Sixth Circuit opinion addressing an *in pari delicto* defense and declining to address the issue of standing); *see also Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards,* 437 F.3d 1145, 1149-50 (11th Cir. 2006); *Schertz-Cibolo-Universal City, Indep. School Dist. v. Wright (In re Educators Grp. Health Trust)*, 25 F.3d 1281, 1286 (5th Cir. 1994).

Head asserts that Fair Finance itself was a wrongdoer with Head when they fraudulently induced individuals to purchase V-Notes. That misconduct, imputed to the trustee, prevents the trustee from recovering from him.[13] He again cites New York law. The trustee responds that the defense does not bar claims by a corporation against its own insiders[14] and that Head, as Fair Finance's President, was an insider.[15]

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[13] Head Mem., District Court case 5:13-cv-2098, docket 33 at 9.

[14] *See* 11 U.S.C. § 101(31)(B).

[15] This is a different aspect of the doctrine than the one at issue in *Bash v. Textron Financial Corp.*, 483 B.R. 630, 650-652 (N.D. Ohio 2012). In that case, the trustee brought suit against non-insiders and the parties did not raise this part of the defense.

In invoking the insider exception, the trustee relies on the undisputed fact that Head, as the debtor's President during the relevant time period, is an insider. He then cites the substantial body of case law holding that the defense "does not apply to bar claims against corporate insiders." *Liquidating Trustee of the Amcast Unsecured Creditor Liquidating Trust v. Baker (In re Amcast Indus. Corp.)*, 365 B.R. 91, 124 (Bankr. S.D. Ohio 2007); *see also OHC Liquidation Trust v. Credit Suisse (In re Oakwood Homes Corp.)*, 356 Fed. Appx. 622 at *4 (3d Cir. 2009) (unpublished opinion) (noting that the doctrine generally does not apply when one party controls the other "because it would allow a defendant that controlled a plaintiff to avoid liability by blaming the plaintiff it controlled."); *In re Nat'l Century Fin. Enter., Inc., Investment Litig.,* 617 F. Supp.2d at 712-13 (collecting cases on this issue); *Stanziale v. McGladrey & Pullen, LLP (In re Student Fin. Corp.)*, 2006 WL 2346373 at *2 (D. Del. 2006) (noting that *in pari delicto* does not bar claims made against insiders of a debtor corporation).

The *Amcast* and *National Century* cases, both of which apply Ohio law, are instructive. In *Amcast*, the bankruptcy court considered whether *in pari delicto* barred a liquidating trustee from bringing an Ohio law claim against the debtor's officers and directors. The court applied the insider exception and found that the doctrine did not protect these insiders, stating that if it were otherwise "neither a corporation nor the successor bankruptcy trustee could sue the corporation's insiders on account of their own wrongdoing." *Amcast Indus. Corp.*, 365 B.R. at 124. Similarly, in the *National Century* case a district court applying Ohio law held that the doctrine did not apply to bar the liquidating trustee from pursuing claims against insiders of the debtor corporation. *In re Nat'l Century Fin. Enters., Inc. Investment Litig.*, 617 F. Supp.2d at 712-13. This reasoning is persuasive.

Head, as the President of Fair Finance at the time of the events at issue, is a corporate insider. As a result, the defense of *in pari delicto* is not available to him.

D. Civil Rule 9(b)

Head filed an answer in 2010 and raised as a defense that the cross-claim did not state fraud with the required particularity.[16] *See* FED. R. CIV. P. 9 (made applicable by FED. R. BANKR. P. 7009). The docket does not reflect any other activity by Head on this issue until he filed his motion for summary judgment about four years later. Other defendants moved to dismiss at the outset, arguing among other things that count 7 failed to plead fraud with particularity and that the omission warranted a dismissal for failure to state a claim under Civil Rule 12(b)(6).[17] The predecessor bankruptcy judge denied each of those motions by order (the 9(b) Order).[18] Head now moves for summary judgment on this issue.

Head's first argument is that the 9(b) Order required the trustee to amend his cross-claim after discovery to assert the fraud claims with more detail, which the trustee did not do. As a result, Head urges the court to dismiss for failure to comply with that order, which failure allegedly leaves the 9(b) requirements unmet. The trustee counters that the 9(b) Order does not put such an affirmative obligation on him. While the 9(b) Order could have included a directive to the trustee to amend his cross-claim, this court agrees that it did not.

Head argues next that summary judgment is appropriate because the count 5 fraud claim [the second one labeled count 5 in the cross-claim] against other individuals does not assert a

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[16] Docket 37.

[17] Docket 33, 38, and 40.

[18] Docket 64.

claim against him and does not meet the 9(b) requirement that a party alleging fraud "must state with particularity the circumstances constituting fraud[.]" FED. R. CIV. P. 9(b). The purpose of Civil Rule 9(b) "is to alert defendants 'as to the particulars of their alleged misconduct' so that they may respond." *Chesbrough v. VPA, P.C.*, 655 F.3d 461, 466 (6th Cir. 2011) (quoting *United States ex rel. Bledsoe v. Cmty Health Sys., Inc.*, 501 F.3d 493, 503 (6th Cir. 2007)). This rule, like all Bankruptcy Rules, must be read in such a way as to "secure the just, speedy, and inexpensive determination of every case and proceeding." FED. R. BANKR. P. 1001. With those principles in mind, the court must consider whether this is an appropriate time for Head to pursue the 9(b) issue.

The case of *Firstar Bank, N.A. v. Faul Chevrolet, Inc.,* 249 F. Supp.2d 1029 (N.D. Ill. 2003) is helpful for the framework it develops on this issue. There, after discovery closed in a case that raised fraud, a defendant moved for summary judgment alleging that the complaint did not meet the 9(b) standards. The district court declined to enter summary judgment on this ground after looking to the policy reasons behind the rule: "Rule 9(b) is intended to protect a defendant's reputation from harm, minimize strike suits and fishing expeditions, and provide notice of the claim to the adverse party." *Id.* at 1043. The court then pointed out that any harm to reputation had occurred many years before, the parties had completed discovery, and the fraudulent nature of the representations was obvious.

Consideration of those factors in this case leads to the same conclusion. Head filed his answer on August 6, 2010. He did not file a motion for a more definite statement before answering, as he could have under Civil Rule 12(e) (made applicable in relevant part by FED. R. BANKR. P. 7012(b)). Any potential damage to his reputation–fairly or unfairly–started years ago

when this adversary proceeding was filed. The parties completed discovery on June 30, 2011, about three years ago.

The third, and perhaps most significant factor, is whether the elements of the alleged fraud are now known to Head. For Civil Rule 9(b) notice purposes, courts have permitted plaintiffs to supplement their complaints through legal memoranda on the ground of judicial economy. *See Bonilla v. Trebol Motors Corp.*, 150 F.3d 77, 81 (1st Cir. 1998) (holding that the plaintiffs' opposition to summary judgment and cited discovery material gave sufficient notice of the alleged fraud as a de facto amendment or supplement to the complaint); *Shekoyan v. Sibley Int'l Corp.*, 217 F. Supp.2d 59, 74 (D.C. 2002) (collecting cases on this point); *see also Ticor Title Ins. Co. v. Title Assurance & Indem. Corp.*, No.1:09-cv-775, 2009 WL 5096806 at n.1 (N.D. Ohio Dec. 17, 2009) (noting that motions based on 9(b) pleading requirements are disfavored at the summary judgment stage and after the close of discovery).

Along these lines, the trustee points to two documents filed within the last few years that he argues gave Head sufficient notice of the fraud allegations: an affidavit and report from the trustee's expert, Howard Klein,[19] and the trustee's proposed findings of fact that include 28 paragraphs explaining the claim against Head.[20] The latter states:

> L. Head facts
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> 143. Head began working at Fair in 1986 as a collections manager. (Head depo. p. 10-11.)
>
> 144. He was promoted to branch manager and then to Assistant Vice-President. (Head depo p. 21-22.)

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[19] District Court case 5:13-cv-2098, docket 30.

[20] Docket 257 at 13-15.

145. Sometime in 1994 or 1995 Head was promoted to Vice-President. (Head depo p. 28.)

146. Head became President of Fair in 2004. (Head depo p. 39).

147. Initially his job responsibilities were overseeing the Customer Contracts. (Head depo p. 40.)

148. Head reported to Durham and Cochran. (Head depo p. 40.)

149. Head entered into a five year employment agreement in 2002. (Head depo p. 34.)

150. On or about July 15, 2003, Head's employment agreement was amended on July 16, 2003 to include a Shadow Stock Plan. Head depo p. 35.

151. The Shadow Stock Plan gave non-voting stock to Mr. Head. This stock would have a certain value when Head left Fair. This value was based upon the profitability of Fair. Head depo p. 36.

152. The amount to be paid under the Shadow Stock Plan was to be paid by Durham and Cochran in their individual capacity. (Head depo p. 36.)

153. Head requested payment pursuant to the Shadow Stock Plan in 2009 even though he knew that Fair was not profitable. (Email from Head to Durham dated 9/3/02.)

154. Head was paid a salary of $170,000 to $180,000 per year by Fair Holdings. Head depo p. 42. He had no job title with Fair Holdings and served no function for it. (Head depo p. 48.)

155. From 2006 to 2009, Head received money from Fair as follows: $246,947.26 in 2006; $244,110.90 in 2007; $272,776.29 in 2008; and $71,286.35 in 2009. (Head depo p. 197-198, Exhibit X.)

156. From 2006 to 2009, Head received money from Fair Holdings as follows: $184,633.13 in 2006; 180,000.00 in 2007; $180,000.00 in 2008; and $25,615.38 in 2009. (Head depo p. 197-198, Exhibit X.)

157. Head was familiar with Fair's offering circulars. He would coordinate with DeRose, Snow and others in their preparation. (Head depo p. 44.)

158. Head was involved in the creation of the 2008 offering circular. (Head depo p. 94.)

159. Head was aware that Fair Holding owed money to Fair shortly after Durham and Cochran purchased Fair and that the amount owed increased over time. (Head depo p. 52.)

160. Head was not concerned about how this debt was being repaid. (Head depo p. 55)

161. Head had access to Fair's bank account statements and does not recall ever seeing a payment from Fair Holdings. (Head depo p. 98.)

162. Head knew that Fair required funds to be invested by additional V-note purchasers in order to had [sic] to repay its V-note holders. (Head depo p. 120-121.)

163. Head knew that Fair's primary sources of income were its Customer Contracts and its V-notes. (Head depo p. 55.) He knew by how much the debt certificates increased from 2002 through 2008. (Head depo p. 55-56.)

164. Head was aware that the money generated by V-notes was loaned to companies owned by Durham and Cochran. (Head depo p. 60-61, 174.)

165. These loans were monitored at Fair Holdings corporate office in Indianapolis.

166. Head prepared two prior year's worth of minutes of meetings of Fair's Board of Directors for the 2007 offering circular showing rate changes to V-notes. These minutes were not prepared at any meeting, rather they were prepared in 2007 in advance of submitting an offering circular to the State of Ohio. (Head depo p. 71 and exhibit D.)

167. Head never met Eglen or Laikin. (Head depo p. 69-70.)

168. Head was involved in preparing a standard operating procedures manual for V-note solicitation. (Head depo p. 123 and exhibit G.)

169. In exchange for his salary, bonuses and shadow stock plan, Head entered into an agreement with Durham and Cochran, either tacit or express, to defraud Fair and Fair's investors.

170. Head's action in furtherance of this agreement caused injury to Fair in the amount of $47,883,262.

The Klein affidavit and report state his opinions, each of which is followed by a detailed basis for the opinion. These are the relevant opinions:

OPINION 1

Timothy Durham and James Cochran acquired Fair Finance to obtain access to its cash raising ability in order to fund their personal high risk business ventures and affluent lifestyles. Durham and Cochran ignored customary business practices to loot Fair Finance for their personal benefits.

OPINION 2

Fair Finance Company and Fair Holdings, Inc. were insolvent as of December 31, 2002 and thereafter.

OPINION 3

Fair Finance Company was insolvent as of December 31, 2002 and thereafter.

OPINION 4

DC Investments, Inc. was insolvent as of December 31, 2002 and thereafter.

OPINION 5

Fair Finance Company evolved into a Ponzi scheme.

OPINION 6

Fair Finance management made numerous material misrepresentations in the January 16, 2009 Offering Circular.

OPINION 7

Fair Finance management made numerous material misrepresentations in the Fair Finance Company and Subsidiary Consolidated financial statements and independent accountants review report for the year ended December 31, 2008 that was reviewed by Wagner & Company CPA LLC.

OPINION 8

Fair Finance management made numerous material misrepresentations in the Fair Holdings, Inc. and Subsidiary Consolidated financial statements (unaudited) years ended December 31, 2007 and 2006 that was certified by Timothy Durham.

OPINION 9

Fair Finance management made numerous material misrepresentations in the Fair Finance Company, a wholly owned subsidiary of Fair Holdings, Inc. financial statements and independent accountants review report for the year ended December 31, 2006 that was reviewed by Seikel & Company, Inc.

OPINION 10

Fair Finance management made numerous material misrepresentations in the Fair Holdings, Inc. and Subsidiary Consolidated financial statements (audited) years ended December 31, 2004 and 2003 that was audited by Somerset CPAs PC.

Assuming without deciding that a motion for a more definite statement or a request to require the trustee to amend his cross-claim after discovery might have been well-taken early on, by now the factual allegations against Head as supplemented by the Klein affidavit and report and the proposed findings of fact are clear. With this information available to him, Head was able to make detailed arguments in his motion for why the court should grant him summary judgment on the merits. He chose as an advocate to focus on what the evidence does not show, but that is not to say that he lacked notice through the supplemental materials of what the trustee argues the evidence *does* show. After considering all of these factors, this court concludes that

no useful jurisprudential purpose would be served by considering the Civil Rule 9(b) argument as a stand-alone reason to grant summary judgment and recommends that it be denied.

E. Is There a Genuine Issue of Material Fact as to the Trustee's Civil Conspiracy Claim?

For purposes of this motion only, Head does not directly dispute that the offering circulars contained material misrepresentations of fact. Instead, he argues that the trustee cannot prove that the V-Note buyers relied on any misrepresentation. Similarly, he does not dispute that Cochran, Durham or others conspired to defraud Fair Finance. Head's position is instead that the trustee cannot prove that Head participated in any such conspiracy. As part of that argument, he contends that the trustee is barred from using either his expert's affidavit and report or testimony from a criminal trial transcript to defend against the motion.

1. Head's Challenge to the Trustee's Evidence

Head objects to this evidence:

(1) the affidavit and report of Howard Klein, CPA;[21] and

(2) excerpts from the certified transcript of the 2012 United States District Court for the Southern District of Indianapolis jury trial which resulted in Cochran's conviction on six counts of wire fraud, one count of securities fraud, and one count of conspiracy to commit wire and securities fraud; Durham's conviction on ten counts of wire fraud, one count of securities fraud, and one count of conspiracy to commit wire and securities fraud; and the conviction of

[21] District Court case 5:13-cv-2098, docket 30.

Rick Snow (Fair Finance Chief Financial Officer) on counts of conspiracy to commit wire and securities fraud, wire fraud, and securities fraud.[22] (Trial Transcript).

Under Civil Rule 56(c), a party asserting that a fact is, or cannot be, genuinely disputed must support that position by citing to materials in the record, including "depositions, documents, electronically stored information, affidavits or declarations, stipulations . . . admissions, interrogatory answers *or other materials*[.]" FED. R. CIV. P. 56(c)(1)(A) (made applicable by FED. R. BANKR. P. 7056) (emphasis added). The general rule is that evidence submitted in opposition to a summary judgment motion must be admissible at trial and that hearsay evidence cannot be considered. *U.S. Structures, Inc. v. J.P. Structures, Inc.*, 130 F.3d 1185, 1189 (6th Cir. 1997). However, "[t]he submissions by a party opposing a motion for summary judgment need not themselves be in a form that is admissible at trial." *Alexander v. Caresource*, 576 F.3d 551, 558 (6th Cir. 2009) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986)). "Otherwise, affidavits themselves, albeit made on personal knowledge of the affiant, may not suffice, since they are out-of-court statements and might not be admissible at trial." *Id.*

In this motion phase, the court focuses on whether the contents of the evidence is admissible, rather than on the form in which it is presented. *North Am. Specialty Ins. Co. v. Myers*, 111 F.3d 1273, 1283 (6th Cir. 1997). Evidence offered in a form that is inadmissible may still be considered if the party offering it shows that he "can make good on the promise of the pleadings by laying out enough evidence that *will be* admissible at trial to demonstrate that a

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[22] *United States v. Durham, et al*, 1:11-CR-00042 (S.D. Ind.) filed in District Court case 5:13-cv-2098, docket 26. All references to the Trial Transcript refer to the original page of the certified transcript located on the upper right hand of the page.

genuine issue on a material fact exists, and that a trial is necessary." *Alexander*, 576 F.3d at 558 (emphasis in original). Therefore, this court may consider evidence offered in an inadmissible form if the trustee as the offering party shows that its substance can be offered in an admissible form at trial.

a. Howard Klein's Expert Affidavit and Report

Head objects that the Klein affidavit and report are hearsay and thus inadmissible.[23] He also states without amplification in a footnote that he does not concede that Klein is an expert.[24]

Klein's affidavit and resume identify him as a certified public accountant, a certified fraud examiner, and a certified insolvency and restructuring advisor. He states that he specializes in bankruptcy and forensic accounting, and he identifies numerous cases involving fraud and bankruptcy where he has served as an expert. The court will consider him to be an expert at this point based on his affidavit and resume, which Head has not substantively challenged.

Evidence Rule 702 permits the admission of expert opinion testimony. FED. R. EVID. 702. And Rule 703 allows a testifying expert to rely on various materials, including inadmissible hearsay, in forming his opinion. FED. R. EVID. 703. Those materials may be admitted into evidence to establish the basis for the expert's opinion. *Engebretsen v. Fairchild Aircraft Corp.*, 21 F.3d 721, 728-29 (6th Cir. 1994). However, to the extent the materials relied on are inadmissible, they may not be admitted for the truth of the matters they contain. *Trepel v. Roadway Express, Inc.*, 194 F.3d 708, 717 (6th Cir. 1999) (citing *Engebretsen*, 21 F.3d at 729);

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[23] Head Reply, District Court case 5:13-cv-2098, docket 48 at 4.

[24] Head Mem., District Court case 5:13-cv-2098, docket 33 at 12-13 n. 4.

see also Fish Farms P'ship v. Winston-Weaver Co., 531 Fed. Appx. 711, 712 (6th Cir. 2013) (unpublished opinion) ("Although Dr. Mills was permitted by FRE 703 to use this hearsay evidence to reach his opinion, the evidence cannot be used for the truth of the matter[.]").

Head contends that the trustee is offering Klein's affidavit and report not to support his opinion, but rather to establish facts. He objects broadly, without identifying any particular statements as subject to the objection.[25] His objection is well-taken in part.

As discussed further below, the trustee uses the affidavit and report in two ways: to support Klein's opinion and to establish certain facts. Where the trustee offers these documents to support Klein's opinion, they are admissible to serve that function even though they may be hearsay. To the extent that the trustee attempts to establish the truth of certain matters through the documents, however, they are hearsay and he has not shown that they are independently admissible. As a result, the matters that fall into the second category may not be admitted as facts under the record before this court.

b. <u>The Trial Transcript</u>

The trustee cites to the criminal trial testimony of (1) Donald Fair, former owner; and (2) Douglas DeRose, Vice President and Controller of Fair Finance. DeRose, who joined Fair Finance in June 2003, was located in the Akron office. He reported to Head and to Snow.[26] Head objects that the Trial Transcript is hearsay and that the trustee did not disclose these individuals as potential witnesses.

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[25] Head Reply, District Court case 5:13-cv-2098, docket 48 at 4.

[26] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098, docket 26, Vol. 1 at 213-215.

Courts generally agree that a certified trial transcript is appropriate evidence in determining a motion for summary judgment. *See, for example, Kelley v. Price-Macemon, Inc.,* 992 F.2d 1408, 1415 n. 12 (5th Cir. 1993) ("It is well-settled that a certified transcript of a judicial proceeding may be considered on a motion for summary judgment."); *Advance Fin. Corp. v. Isla Rica Sales, Inc.,* 747 F.2d 21, 27 (1st Cir. 1984) (noting that a transcript has the hallmarks of reliability and that "there is no sensible rationale which would preclude reliance on sworn testimony faithfully recorded during the conduct of a judicially-supervised adversary proceeding")*; Langston v. Johnson*, 478 F.2d 915, 918 n.17 (D.C. Cir. 1973) (collecting cases); *Ricupero v. Wuliger, Fadel & Beyer*, No. 1:91-cv-0589, 1994 WL 483871 at * 4 (N.D. Ohio Aug. 26, 1994) (same); *see also Adams v. Metiva*, 31 F.3d 375, 382 (6th Cir. 1994) (considering without discussion the plaintiff's evidence in the form of prior testimony and determining that the trial court erred in failing to accept that evidence as true for purposes of summary judgment); *Thomas v. Harvey*, 381 Fed. Appx. 542, 574 (6th Cir. 2010) (noting that "[d]istrict courts routinely consider properly authenticated deposition transcripts [on summary judgment] and hearing transcripts of equal reliability should be treated in the same way"); *but see Patterson v. Cnty. of Oneida, New York*, 375 F.3d 206, 222 (2d Cir. 2004) (stating that a proffer of testimony given in a different case was not competent evidence on summary judgment because as proffered, it was hearsay and was neither reaffirmed by the witness in an affidavit nor supported by a showing that it would be admissible under Federal Evidence Rule 804(b)(1)).

Applying the generally accepted practice, the trial testimony is admissible. Although the testimony may be hearsay in its present form, it is reliable and serves the same purpose as an affidavit. Additionally, the testimony of Messrs. Fair and DeRose at a trial in this adversary

proceeding would not be subject to this evidentiary objection. And even assuming Head's statement in his brief that he did not attend the trial to be true, that would not be grounds to exclude the evidence. *See Ricupero,*1994 WL 483871 at *4. He does not cite any law to support a contrary conclusion.

Head also contends that the evidence should be excluded because the trustee did not disclose DeRose and Fair as persons likely to have discoverable information. He does not identify a legal basis for this argument. While sanctions for failure to make disclosures and to cooperate in discovery are theoretically available under Civil Rule 37, this is not such a motion and does not state grounds to exclude the evidence. *See* FED. R. BANKR. P. 7037 (incorporating FED. R. CIV. P. 37). Additionally, there is no claim that evidence from Fair or DeRose unfairly took Head by surprise because he obviously knew about their roles in these matters and that they were likely to have discoverable information. Thus, no prejudice to Head.

2. <u>The Fraud Claim</u>

As noted above, the trustee alleges this fraud: Cochran, Durham, Snow, Head, and others defrauded V-Note buyers by making material misrepresentations in the offering circulars, including in the attached financial statements and the repeated representation that Fair Finance was continuing to follow its "traditional business plan;" i.e., the long-time conservative one based on financing consumer contracts that was in place before Donald Fair sold the company to Cochran and Durham. The argument goes that the post-sale Fair Finance was entering into fewer of the traditional transactions as a percentage of the debtor's assets and instead was increasingly making risky loans to related parties. Cochran and Durham used the diverted loan money for their own purposes, while Head received (or expected to receive) large amounts of

money through a false "salary" from Fair Holdings and a phantom stock plan for the part he played in running the consumer receivable financing operations. With Fair Finance's assets being diverted in this fashion, it did not have the funds to pay existing V-Note buyers whose notes matured. Thus, the co-conspirators needed to bring in more money from new V-Note buyers to pay off old V-Note buyers whose notes had matured.

Head argues that he is entitled to summary judgment because the trustee cannot prove that the V-Note buyers relied on the alleged offering circular misrepresentations. He supports his position by pointing to an interrogatory that required the trustee to identify individuals likely to have discoverable information to support the claim against Head. The trustee answered by identifying the other defendants and proposed expert Howard Klein. As reliance is an element of the trustee's fraud claim and the trustee did not identify a victim of the alleged fraud, Head argues that the trustee cannot prove fraud. By taking this position, Head has satisfied his initial burden of "showing–that is, pointing out . . . –that there is an absence of evidence to support the nonmoving party's case." *Horton v. Potter*, 369 F.3d 906, 909 (6th Cir. 2004) (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986) (internal quotation marks omitted).

In opposition, the trustee offers Klein's affidavit. There, Klein states his opinions that management made material misrepresentations in the Fair Finance financial statements for the years ended December 31, 2003, 2004, 2006, 2007, and 2008. He also opines that management made material misrepresentations to V-Note buyers through its January 16, 2009 Offering Circular and that the representations were patently false because the circular represented that Fair Finance had outstanding loans made to its shareholders, officers, and directors and falsely

represented that the loans were on terms that would have been available through third-party lenders and at commercially available rates.[27]

Further, the trustee offers the trial testimony of Douglas DeRose, the Fair Finance Vice President and Controller. His responsibilities as Controller "were to generate the internal financial statements for the company, manage the accounting department, handle . . . [Human Resources], as well as investment certificate department . . . [and] cash flow."[28] He reported throughout to Head and to Rick Snow. Among other things, DeRose testified that each potential buyer received an offering circular when the person went to a Fair Finance office to buy V-Notes.[29] Thus, from the trustee's point of view, he presents evidence that each buyer received an offering circular which contained a material misrepresentation of fact. The trustee contends that his proof is sufficient under Ohio law to support the inference that investors (as a group) relied on false statements in the offering circulars in deciding to buy V-Notes.

The trustee cites *Cope v. Metro. Life Ins. Co.*, 82 Ohio St.3d 426, 696 N.E.2d 1001 (Ohio 1998). There, the plaintiff was trying to certify a class action. Those opposing argued that the class should not be certified because each member of the class would have to show that he or she had relied on the alleged misrepresentation. The court rejected the argument, stating:

> It is not necessary to establish inducement and reliance upon material omissions by direct evidence. When there is nondisclosure of a material fact, courts permit inferences or presumptions of inducement and reliance. Thus, cases involving

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[27] Klein Affidavit at ¶ 12 and ¶ 32, District Court case 5:13-cv-2098, docket 30.

[28] Trial Transcript, DeRose testimony, vol. 1 at 212-213, filed in District Court case 5:13-cv-2098, docket 26.

[29] Trial Transcript, DeRose testimony, vol. 1 at 229, filed in District Court case 5:13-cv-2098, docket 26. Certified copies of the offering circulars are at docket 186.

> common omissions across the entire class are generally certified as class actions, notwithstanding the need for each class member to prove these elements.

Cope, 696 N.E.2d at 1008. The trustee also cites *Hansen v. Landaker*, 2000 WL 1803944 (Ohio Ct. App. 2000), which applies the same reasoning.

The trustee has produced sufficient evidence of reliance to avoid summary judgment against him for two reasons. One reason is that under Ohio law, fraud–including the reliance element–can be proven through circumstantial evidence. *Pyles v. Johnson*, 143 Ohio App.3d 720, 758 N.E.2d 1182, 1195 (Ohio Ct. App. 2001); *Owens-Corning Fiberglas Corp. v. Am. Centennial Ins. Co.*, 74 Ohio Misc.2d 183, 660 N.E.2d 770, 779 (1995); *see also Capital Plus, Inc. v. Parker Enters. Imperial Distrib., Inc.*, No. C-030046, 2004 WL 1635721 at *10-11 (Ohio Ct. App. July 23, 2004) (affirming a finding of reliance based on circumstantial evidence). The evidence that each potential buyer received an offering circular before making a purchase supports the logical inference that the buyer relied on the information in that document. As DeRose testified, the purpose of offering circulars is to give potential buyers enough information about the offer to make an informed decision.[30] The *Cope* decision recognized this principle in a similar situation. Thus, viewing the evidence in the light most favorable to the trustee as the non-moving party, a reasonable trier of fact could find that the false financial information about how Fair Finance operated supports an inference or presumption that V-Note buyers relied on the false statements.

[30] Trial Transcript, Fair testimony, filed in District Court case 5:13-cv-2098 at docket 26, Vol. 1 at 40.

The second reason is this: although the V-Note buyers' reliance is an element of the trustee's overall case, it is not an element of his fraud claim. As discussed, the trustee is asserting the fraud claim on behalf of Fair Finance. The trustee's claim, again, can be thought of as having two steps: first, he alleges that the conspirators committed fraud against the V-Note buyers through the offering circulars that had materially misleading information. Then, the conspirators committed fraud against Fair Finance by using the invested money not for Fair Finance's benefit, but for the conspirators' personal benefit. Therefore, while the trustee has alleged that investors relied on the offering circulars and has acknowledged that he must prove such reliance as part of his case, he is not bringing a claim for fraud on behalf of the investors. In that context, reliance by the investors can be established through exactly the type of evidence which the Trustee has produced–evidence that each potential investor was given an offering circular which contained false information as to the terms under which the debtor made the loans outstanding to its shareholders, officers and directors. When that evidence and its logical inferences are viewed in the light most favorable to the trustee, the trustee has offered sufficient evidence of reliance to withstand summary judgment.

3. <u>The Civil Conspiracy Claim</u>

As to the civil conspiracy claim, Head argues that there is no proof that he conspired with others to defraud Fair Finance. As evidence, Head cites: (1) the trustee's response to interrogatory, which only identified Klein and the other defendants as individuals having information to support his claim against Head; (2) the absence of testimony by the other defendants suggesting that Head participated in any fraudulent scheme; and (3) Klein's deposition testimony, in which he failed to identify any person who he had interviewed who had

said something negative about Head or any written acknowledgment by anyone, including Head, that the offering circulars contained false information. Head also refers to his own deposition testimony in which he stated that after Durham and Cochran bought the company, they quickly moved all of the financial management from the Akron offices to Indianapolis, including the office of CFO Snow. And that, although Head was serving as the Vice President and Director of Operations at the time and was promoted to President in 2004, he was excluded from all aspects of the related-party loan transactions that caused Fair Finance to lose millions of dollars. Again, Head has carried his initial burden on summary judgment, which requires the trustee to respond with facts from which a reasonable fact finder could conclude that Head conspired to defraud.

The trustee's claim against Head is based on his role as President of Fair Finance and his involvement with Durham and Cochran in their efforts to sell V-Notes by issuing materially false offering circulars. The trustee argues that Head's participation in the conspiracy need not be proven through direct evidence; he points to portions of Head's deposition testimony, the Trial Transcript, and Klein's affidavit and report to establish facts and circumstances from which Head's participation in a conspiracy to defraud can reasonably be inferred.

Returning to the discussion of the Klein affidavit and report, the trustee must do more than point to the Klein documents to establish that certain matters may be considered on summary judgment. Where the trustee seeks to have matters admitted for the truth, he must establish for each such fact (1) the source of the fact; and (2) that the underlying source is independently admissible. *See* FED. R. EVID. 602, 802, and 803. He has not always done so. For example, the trustee's brief states as fact that "Durham and Cochran began taking money from Fair immediately after they acquired it. Durham withdrew over $2.5 million within three

months of acquisition. Klein Affidavit ¶ 19; Klein Report p. 12."[31] Klein's affidavit paragraph 19 states the amount as $2.6 million but is otherwise identical; Klein's Report page 12 states the amount of $2,652,831.90 but is otherwise identical with the addition of the words "exhibit 4."[32] The trustee does not lay out the argument for why this information is independently admissible and thus it cannot be used to prove the truth.[33]

Based only on the trustee's admissible evidence and viewing it in the light most favorable to him as the non-moving party, the following facts are presented, together with inferences that may appropriately be drawn from them:

a. How Donald Fair Operated Fair Finance[34]

In 2001, Fair Finance was a solvent corporation with an effective business plan that had been in place for many years. Fair Finance provided financing to dealers by purchasing contracts the dealers had entered into with their consumer customers. An example: a consumer purchases a gym membership and agrees to pay for it over time.[35] The gym would sell the right to collect the contract amount to Fair Finance, which would pay a discounted amount to the gym.

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[31] Trustee Resp., District Court case 5:13-cv-2098, docket 43 at 2.

[32] The court notes that there is no exhibit A attached to the filing.

[33] This problem does not exist where the trustee cited not only the Klein affidavit and report, but a separately admissible piece of evidence (such as the Trial Transcript) to support the truth of a statement.

[34] These facts are taken from Donald Fair's testimony in the Trial Transcript in *United States v. Durham, et al.*, Case No. 1:11-CR-00042 (S.D. Ind.), filed in District Court case 5:13-cv-2098, docket 26.

[35] *Id.* at 34-35.

Additionally, Fair Finance serviced consumer contracts (i.e. billed and collected accounts) for third-parties.

Fair Finance financed its operations through the activity just described and also by selling V-Notes to Ohio residents.[36] The Ohio Division of Securities reviewed the draft offering circulars, although it did not approve or disapprove them.[37] Fair Finance always had a certified public accountant prepare the financial statements attached to the offering circulars that it submitted to the regulators.[38]

Fair Finance routinely set the interest rate it offered on its V-Notes at about 1% above the rate offered by savings and loans.[39] Initially, in 1949, the certificates matured in five years. As Fair Finance paid off its bank debt, the maturity date came down over time until eventually the V-Notes all matured at six months.[40] Fair Finance would only accept $50,000.00 from any one investor because Donald Fair thought that the people he dealt with should diversify their investments. He also wanted to minimize the potential for a situation where a V-Note buyer would have a large redemption claim at a time that might not be maximal for the company. In addition to financing operations through the dealer consumer financing, the servicing of

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[36] *Id.*

[37] *Id.* at 36-37.

[38] *Id.*

[39] *Id.* at 38.

[40] *Id.* at 38.

contracts, and the sale of V-Notes, Fair Finance retained a lot of its earnings to reinvest in the company.[41]

When Donald Fair sold the company to Durham and Cochran, Fair Finance had $50 million in accounts receivable and $38 million in outstanding V-Notes. The company did not have any loans to insiders or any bank debt.[42]

A reasonable trier of fact could conclude from these facts that Donald Fair, like his father before him, ran the company in a fiscally sound manner focused mostly, if not entirely, on consumer finance transactions.

b. How Fair Finance Was Operated After Mr. Fair Sold it

After Durham and Cochran bought the company in 2002, the sale of V-Notes rather quickly developed into a scheme in which earlier V-Note buyers were paid with the money provided by later V-Note buyers. Under this scheme, the sale of V-Notes as a percentage of the debtor's assets increased[43] and the traditional receivables financing declined.[44] Fair Finance almost immediately began loaning substantial amounts of money from the sale of the V-Notes to related entities, including Fair Holdings, DC Investments, LLC, Obsidian Enterprises, and individuals.[45] A related party loan was "a loan that was made by Fair Finance through [Fair

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[41] *Id.* at 31, 36-40. Retained earnings refers to net profits kept in a business after dividends, if any, are paid. *See* DICTIONARY OF FINANCE AND INVESTMENT TERMS 512 (5th ed. 1998).

[42] *Id.* at 36 and 44.

[43] Head Deposition (Dep.), docket 183 at 120.

[44] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098 at docket 26, Vol.1 at 230-231.

[45] *Id.* at 232-233.

Holdings] or directly to a party that was related to Fair [Finance] or to Obsidian Enterprises, one of Mr. Durham's companies, or an individual who was affiliated with Obsidian Enterprises."[46] After the transfer, Fair Finance would have a receivable or an IOU from the person or entity that received the money.[47] A few years after 2003, Fair Finance stopped having its financial statements audited by a certified public accountant.[48]

When Cochran and Durham purchased Fair Finance in 2002, the core of the company's business was the financing of consumer receivables; it had no related party loans.[49] That soon changed as the amount of financing receivables declined, and the sale of V-Notes and the amount of related party loans increased.[50] The related party loans constituted the majority of the company's assets in 2007 and thereafter. And by late 2007 or early 2008, Fair Finance's core business was no longer the financing of accounts receivable.[51] Fair Finance obtained the funds needed to make these loans by increasing its sale of V-Notes.[52] Yet, in 2008 when the related party loans had increased to the point that they constituted a majority of Fair Finance's assets

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[46] *Id.* at 230.

[47] *Id.* at 233.

[48] *Id.* at 230.

[49] Trial Transcript, Fair testimony, filed in District Court case 5:13-cv-2098 at docket 26, Vol. 1 at 51 and 57; Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098 at docket 26, Vol.2 at 450.

[50] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098, docket 26, Vol. 1 at 229-30.

[51] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098, docket 26, Vol.2 at 451-52.

[52] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098, docket 26, Vol.1 at 251-253.

and its retail operations were a minority part of the business, the Fair Finance offering circulars continued to assure investors as they had for years that the company was following its "traditional business plan."

c. Head's Employment

Head began working for Fair Finance in 1986. When Cochran and Durham purchased Fair Finance in 2002, they made it a condition that Head, then a Vice President, would remain with the company. Head agreed to stay and entered into a five-year employment contract. He became President in 2004.

In 2003, Fair Finance and Head amended his employment contract to allow him to participate in a Shadow Stock Plan.[53] Cochran and Durham set this up so that Head "could participate in the financial success of [Fair Finance] and to thereby motivate such employees and encourage them to remain in the employ of [Fair Finance]."[54] The plan provided that when Head left Fair Finance under certain circumstances, he would be paid an amount calculated by reference to Fair Finance's financial picture. Even though Head worked for Fair Finance, that company had no obligation under the plan. Instead, Cochran and Durham structured the arrangement so that they would make these payments from their own pockets.[55] There is no explanation for why they did this in this manner.

Starting in 2006, in addition to receiving a salary from Fair Finance, Head received a

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[53] A shadow stock plan, sometimes called a phantom stock plan, is a long-term benefit plan where an employee "is given units having the same characteristics as the employer's stock share . . . the employee does not actually hold any shares but instead holds the right to the value of those shares." BLACK'S LAW DICTIONARY 1183 (8th ed. 2007).

[54] Head Dep., exh. A, docket 183.

[55] *Id.* at 189 and exh. A.

salary from Fair Holdings. He admitted that he did not provide any services to that entity; the only explanation he offered for why he received this additional money is because Fair Holdings "needed to have an Ohio employee, and I was told that that was going to be me, as well as the statutory agent." [56] From 2006 to 2009, Head received this money:[57]

	Fair Finance Salary	Fair Holding Salary
2006	$246,947.26	$184,633.13
2007	$244,110.90	$180,000.00
2008	$272,776.29	$180,000.00
2009	$ 71,286.35	$ 25,615.38
TOTAL	$835,120.80	$570,248.51

Head gave notice of his resignation in December 2008, which became effective on January 7, 2009. He continued to do consulting work for Fair Finance.[58] Head made demand on Cochran and Durham for amounts due under the Shadow Stock Plan, which by his calculations consisted of $430,530.57 due immediately and $1,291,591.70 plus interest over 36 months.[59] After several months, he had received about $10,000.00.

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[56] *Id.* at 42.

[57] *Id.* at 197-198 and exh. X.

[58] *Id.* at 38.

[59] *Id.* at 199 and exh. Y.

d. The Offering Circulars

Everyone who purchased a Fair Finance V-Note received an offering circular.[60] Head was involved in preparing the company manual that Fair Finance used to "offer a point of reference for those involved in the sale of the investment certificates, answers to certain questions that may come up."[61] He and DeRose created a training program for the investment certificates called Fair Finance University.[62]

Over the years, Head was also involved in preparing the offering circulars:

> I would be notified by the controller of the company [DeRose] and/or counsel for the company that an offering circular was about to mature or expire; whether it be the total amount of sales had been achieved or the time of authorization had passed. When I would receive that notification, I would generally ask Mr. DeRose to work with Mr. Snow to prepare respective data. Mr. DeRose,[sic] would begin to update the data as it related to the retail installment operations. Mr. Snow would, along with whomever he worked with on that end, would handle the intercompany piece. From time to time, questions would be raised and if they came to me, I would forward them on to the appropriate parties for answer.[63]

In 2007, Ronald Kaffen, one of Fair Finance's lawyers, asked him for input in connection with the drafting of the 2007 offering circular. The draft circular stated that Fair Finance's board of directors approved the interest rate that would be paid on the V-Notes. When Kaffen asked if "there were written minutes prepared when the rates are changed," Head responded "We do not

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[60] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098, docket 26, Vol.1 at 223.

[61] Head Dep., Docket 183 at 123.

[62] Trial Transcript, DeRose testimony, filed in District Court case 5:13-cv-2098, docket 26, Vol. 2 at 466.

[63] Head Dep., docket 183 at 44.

keep minutes on this, but will prepare them for the past two years. No problem."[64] Head was also involved in the preparation of the July 2008 offering circular.[65]

As President of Fair Finance, Head was also aware that:

(1) the amount of money which Fair Holdings owed to Fair Finance increased dramatically over time, rising from zero on the day of the 2002 purchase to over $100 million.[66]

(2) although Head knew that Fair Finance was loaning large amounts of money to Fair Holdings, he did not recall ever seeing any agreements granting Fair Finance any security interest in collateral owned by Fair Holdings.[67]

(3) for a few years following June 2003, Fair Finance followed the Fair family's long-standing practice of having its financial statements audited. Then Fair Finance ended that practice.[68]

(4) Fair Holdings was not making payments on the debt.[69]

(5) the flow of money to Fair Holdings came in part from the sale of V-Notes, which sales were increasing.[70]

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[64] *Id.* at 44, 71 and exh. D.

[65] *Id.* at 93-94.

[66] *Id.* at 52-55, 98 and 105.

[67] *Id.* at 100.

[68] Trial Transcript, DeRose testimony, filed in District Court Case 5:13-cv-2098, docket 26, Vol. 1 at 230.

[69] Head Dep., docket 183 at 98.

[70] *Id.* at 55-56.

(6) in 2007, it was generally Head's understanding that the V-Note money "was used to fund this intercompany debt owing to Fair Holdings or owing to Fair Finance from Fair Holdings."[71]

(7) To the extent that Fair Holdings did not repay the money loaned to it by Fair Finance, Fair Finance needed new V-note buyers to provide funds so that Fair Finance could pay buyers whose V-Note certificate had reached maturity and who wanted to redeem rather than re-invest in V-Notes.[72]

Head attempts to characterize the facts in a manner that removes him from the fray and limits his authority and knowledge to Fair Finance's consumer receivables business. However, that is not the standard for summary judgment. Looking at the trustee's evidence and the logical inferences that can be drawn from it in the light most favorable to the trustee, the evidence shows that a material issue of fact exists as to whether Head conspired with Cochran and Durham to defraud Fair Finance. Based on Head's multi-year role as the President of Fair Finance, the more than half a million dollars he received from Fair Holdings without doing any work for it, his participation in the Shadow Stock Plan with the promise of substantial additional amounts of money to be paid to him by Cochran and Durham individually, his participation in the preparation of offering circulars, and his knowledge of the finances and inner-workings of Fair Finance, a reasonable trier of fact could conclude that–in exchange for being paid a great deal of money with more money promised by Cochran and Durham under the Shadow Stock Plan–Head at least tacitly agreed to allow Fair Finance to be run fraudulently to the ultimate detriment of Fair

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[71] *Id.* at 60.

[72] *Id.* at 120-121 and 151-153.

Finance. And when all was said and done, in a matter of years the previously solid Fair Finance ended up insolvent, a chapter 7 debtor with claims against it in the millions.

Head may be correct that all of this evidence can be viewed in a different way that makes him an innocent bystander, but in this court's opinion that is an issue for trial, not for resolution by summary judgment.

Based on this discussion, this court recommends that the district court deny Head's motion for summary judgment.

Pat E. Morgenstern-Clarren
Chief Bankruptcy Judge