IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
Civil Action No: 3:14-CV-00091

KENNETH D. BELL, in his capacity as court-appointed Receiver for Rex Venture Group, LLC d/b/a ZeekRewards.com,

Plaintiff,

v.

TODD DISNER, in his individual capacity and in his capacity as trustee for Kestrel Spendthrift Trust; TRUDY GILMOND; TRUDY GILMOND, LLC; JERRY NAPIER; DARREN MILLER; RHONDA GATES; DAVID SORRELLS; INNOVATION MARKETING, LLC; AARON ANDREWS; SHARA ANDREWS; GLOBAL INTERNET FORMULA, INC.; T. LEMONT SILVER; KAREN SILVER; MICHAEL VAN LEEUWEN; DURANT BROCKETT; DAVID KETTNER; MARY KETTNER; P.A.W.S. CAPITAL MANAGEMENT LLC; LORI JEAN WEBER; and a Defendant Class of Net Winners in ZEEKREWARDS.COM;

Defendants.

MEMORANDUM IN SUPPORT OF DEFENDANTS' JOINT MOTIONS TO DISMISS PURSUANT TO RULES 9, 12(b)(1) AND 12(b)(6)

Defendants Trudy Gilmond, Trudy Gilmond, LLC, Jerry Napier, Darren Miller, Rhonda Gates, Innovation Marketing, LLC, Aaron Andrews, Shara Andrews and Durant Brockett, ("Moving Defendants") move to dismiss the complaint filed by Kenneth D. Bell ("Plaintiff" or "Receiver") pursuant to Rule 12(b)(1) because the Court lacks subject matter jurisdiction over this matter and pursuant to Rules 9 and 12(b)(6) because the Receiver has failed to state a claim for which relief can be granted.

I. INTRODUCTION.

This case had its genesis when the Court appointed the Receiver on August 17, 2012 in *Securities and Exchange Commission v. Rex Venture Group, et al.*, No. 3:12-CV-00519-GCM (the "SEC Matter"). *See* SEC Matter, Doc. No. 4. After 18 months of investigation and millions of dollars in fees, on February 28, 2014, the Receiver filed the Complaint in the present action in which he (1) alleges that Rex Venture Group ("RVG") d/b/a ZeekRewards operated a massive Ponzi scheme, and (2) attempts to claw back from 17 named ZeekRewards affiliates and "approximately 9000 net winners" earnings the defendants made through their good faith work for ZeekRewards. The Complaint asserts three causes of action: (1) Fraudulent Transfer of RVG Funds in Violation of the North Carolina Uniform Fraudulent Transfer Act; (2) Common Law Fraudulent Transfer; and (3) Constructive Trust. Notwithstanding that the Complaint spans 40 pages and 177 paragraphs, the Receiver fails to make a single factual allegation specific to any Moving Defendant except for their places of residence and that they were Net Winner Affiliates.[1]

The Complaint must be dismissed pursuant to Rule 12(b)(1) because the Court lacks subject matter jurisdiction, among other reasons, because RVG was not involved in the sale or

[1] Capitalized terms not defined herein have the meaning ascribed to them in the Complaint.

marketing of any securities, and none of the Moving Defendants (or other Affiliates) purchased, invested in or otherwise acquired any securities from Rex Venture Group, LLC ("RVG"). Contrary to the Receiver's assertions that Affiliates earned "passive income" in connection with ZeekRewards (a requirement of a security), the Moving Defendants (and most other successful Affiliates) worked hard to promote RVG and its penny auction business in order to earn income. They were not passive investors, but rather professional marketers who actively participated in legitimate promotional and advertising activity designed to "drive traffic" to RVG's penny auction website, Zeekler.com. The Court's jurisdiction in the SEC Matter is predicated on alleged securities fraud by RVG. However, because RVG did not sell or offer for sale any security and because neither the Moving Defendants nor any other Affiliates in the present matter purchased or acquired any security from RVG, the Court lacks subject matter jurisdiction over the SEC Matter. Because the Receiver's authority to file the instant lawsuit is derived from the Court's jurisdiction in the SEC Matter, the fact that the Court lacks subject matter jurisdiction in that matter means the appointment of the Receiver was improper and that the Court lacks subject matter jurisdiction over the instant lawsuit.

Additionally, each of the claims for relief in the Complaint must be dismissed for failure to state a claim upon which relief can be granted:

- The First Claim for Relief, Fraudulent Transfer of RVG Funds in Violation of the North Carolina Uniform Fraudulent Transfer Act ("NCFTA"), must be dismissed: (1) pursuant to Rule 12(b)(6) because (a) the Receiver is not a "creditor" as defined in the NCFTA and has no standing to pursue fraudulent transfer claims and (b) the Complaint fails to meet the pleading requirements enunciated in *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) and *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); and (2) pursuant to Rule

9(b) because the Complaint fails to plead fraud with the requisite degree of specificity. In this regard, the Complaint: (a) fails to make a single factual allegation against any of the named defendants (other than alleging their places of residence and that they were Net Winner Affiliates); (b) constitutes a bare recital of the statutory elements of fraudulent transfer; and (c) fails to identify the dates or amounts of any fraudulent transfers allegedly made by any of the named defendants.

- The Second Claim for Relief, Common Law Fraudulent Transfer, must be dismissed pursuant to Rule 12(b)(6) because this claim does not exist in North Carolina.
- The Third Claim for Relief, Constructive Trust, must be dismissed pursuant to Rule 12(b)(6) because "constructive trust" is not a cause of action; rather, it is a remedy for breach of fiduciary duty or unjust enrichment. Alternatively, the Complaint fails to allege any wrongdoing by any of the named defendants sufficient to give rise to the imposition of a constructive trust and fails to allege any facts to support the Complaint's naked assertion that the Receiver has no adequate legal remedies.

II. SUMMARY OF THE ALLEGATIONS IN THE COMPLAINT.[2]

RVG allegedly operated "a massive Ponzi and pyramid scheme" through ZeekRewards from at least January 2011 until August 2012 in which over 700,000 participants lost over $700 million dollars. (Comp., ¶ 1.) Each of the Moving Defendants was an affiliate of ZeekRewards "who received more money from Zeek than they paid in to Zeek." (*See id.*, ¶¶ 2, 13, 14, 15.)

[2] Although the Moving Defendants dispute many of the facts alleged in the Complaint, for purposes of the Rule 12(b)(6) motion, they understand that the Court must accept as true the Complaint's well pleaded factual allegations. However, the Court should reject legal conclusions and formulaic recitations of the elements of a claim. *Francis v. Giacomelli*, 588 F.3d 186, 191-93 (4th Cir. 2009), *citing Twombly*, 550 U.S. at 555.

The Securities and Exchange Commission filed the SEC Matter in this District pursuant to Sections 20(b), 20(d)(1) and/or 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a)] and Sections 21(d)(1), 21(d)(3)(A), 21(e) and/or 27 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d)(l), 78u(d)(3)(A), 78u(e) & 78aa to halt the ZeekRewards alleged fraudulent scheme and freeze RVG's assets. (*Id.*, ¶ 26). Plaintiff is the Receiver appointed by this Court in the SEC Matter. (*Id.*, ¶ 5.)

In 2010, RVG launched Zeekler.com, a "penny auction" website where items ranging from personal electronics to cash were auctioned to bidders. (*Id.* ¶ 59.) During 2010, the Zeekler penny auctions were not very successful, but RVG's fortunes changed in 2011 when RVG launched ZeekRewards. RVG promoted ZeekRewards as Zeekler.com's "private, invitation-only affiliate advertising division." Plaintiff alleges that ZeekRewards was just a multi-level marketing scheme grafted onto the Zeekler business and that it purported to pay a portion of the profits from the Zeekler penny auction business to participants who earned bid balances or points, primarily by buying auction bids. RVG told potential participants, "Zeekler tallies total sales and pays a percentage to all active ZeekRewards members." Also, participants in ZeekRewards, often called "Affiliates," were paid for recruiting other participants in a pyramid "multi-level" sales format. Bidders on the Zeekler penny auctions could purchase bids at retail for $0.65, or they could acquire bids as ZeekRewards Affiliates (or as free samples from RVG or an Affiliate). (*Id.* ¶¶ 61-63.)

The Receiver alleges that the over $400 million dollars that was paid out to ZeekRewards Affiliates came almost entirely from new participants rather than income from the Zeekler penny auctions and that only about $10 million dollars in retail bids were sold (of which $3.6 million reflected purchases by net losing Affiliates). So, the "profit" from the penny auction business, if there was any at all, was too small to support even 3% of the total payments made to participants.

Burks and the other Insiders were aware that the payouts to Affiliates would be funded by new participants rather than retail profits from the penny auctions. (*Id.* ¶¶ 71-72.)

The Complaint does not allege that Affiliates actively worked for the compensation that they received from RVG. However, facts pertaining to the work that Affiliates performed for RVG are relevant to the Moving Defendants' Rule 12(b)(1) motion.[3] In particular, ZeekRewards offered independent professional online marketers an opportunity to "Be Your Own Boss" and "earn Income" for "driving traffic" to Zeekler's penny auction website. (App., Ex. L, pp. 2-3) The ZeekRewards program was outlined in detail on its website, which noted that: (1) "ZeekRewards is designed to be an online-based business" (*Id.*, pp. 29, 36); (2) "Income is earned through the dedicated efforts of Affiliates making sales and good old fashioned hard work" (*Id.*, p. 22); (3) "Whether you're a part-time non-recruiter or a seasoned sales professional, ZeekRewards offers you an opportunity to create whatever income and life-style you desire" (*Id.*, p. 3); and (4) "The opportunity presented is based on proven money-making systems . . . . As is true in much of life, real success usually requires real work" (*Id.*, pp. 32-33).

The Moving Defendants and other Affiliates worked hard to earn the income they received from RVG. The Moving Defendants: (1) drove new customers to the penny auction site (Zeekler.com); (2) promoted the penny auction by placing daily advertisements on the internet; (3) networked with other marketing professionals to gain greater exposure for Zeekler and

[3] The Court can consider these facts, and allow limited discovery on them, for purposes of resolving Defendants' Rule 12(b)(1) motion. *See Richmond, Fredricksburg & Potomac R.R. Co. v. United States*, 945 F.2d 765, 768-69 (4th Cir. 1991). Defendants' 12(b)(1) Motion is supported by the declarations of Aaron Andrews, Durant Brockett, Trudy Gilmond, David Kettner, Mary Kettner, Kellie King, Darren Miller, Jerry Napier, David Sorrells and Christopher Villamil (the Kettner, Sorrells, King, Gilmond and Villamil declarations were filed previously in the SEC Matter). The evidence tendered in support of the 12(b)(1) motion is contained in the Appendix in Support of Defendants' Joint Motion Pursuant to Rule 12(b)(1) to Dismiss Complaint, which is being filed separately. Defendants will usually cite the evidence as "App., Ex. __, ¶__".

ZeekRewards; (4) set-up websites to drive traffic to Zeekler and ZeekRewards; (5) recruited customers and new members; (6) participated in training programs and leadership calls; and (7) participated in mandatory compliance programs sponsored by ZeekRewards. (*See* App. Exh. A, ¶¶3, 5, 7; App. Ex. B, ¶¶5, 9; App. Ex. C, p. 1; App. Ex. D, ¶¶3-6; App. Ex. E, ¶¶5-6; App. Ex. F, ¶¶5-6; App. Ex. G, p. 1; App. Ex. H, ¶¶ 3-6, 12; App. Ex. I, ¶¶3, 8; App. Ex. J, ¶¶3, 8; App. Ex. K, ¶¶5-6.) The Moving Defendants considered their participation in the ZeekRewards program their livelihood, most of them worked many hours per week promoting ZeekRewards and Zeekler.com, and it was their primary source of income. (*See* App. Exh. A, ¶¶9, 6; App. Ex. B, ¶¶8, 12; App. Ex. C, p.1; App. Ex. E, ¶¶5, 7; App. Ex. F, ¶¶5, 7; App. Ex. G, p. 1; App. Ex. I, ¶¶2, 7; App. Ex. J, ¶¶2, 7; App Ex. K, ¶¶5, 7.)

Recognizing that the Moving Defendants were working for RVG, RVG issued IRS Forms 1099-MISC to the Moving Defendants to document the compensation to them for their services. (*See* App. Exh. A, ¶¶8, 11 and attachment; App. Ex. B, ¶¶16, Ex. 1; App. Ex. I, ¶12; App .Ex. J, ¶12.) In fact, after the SEC Matter was filed, *the Receiver*, acting on RVG's behalf, issued forms 1099-MISC. Thus, even the Receiver apparently considers the Moving Defendants' RVG income as income earned from work.[4] (*Id*.) And the Moving Defendants paid federal and state taxes on the income they received. . (*See* App. Exh. A, ¶9; App. Ex. B, ¶17; App. Ex. E, ¶7; App .Ex. F, ¶7; App. Ex. K, ¶7.)

[4] The IRS states that form 1099-MISC is to be used to report, among other types of income "nonemployee compensation of $600 or more," including fees, commissions, prizes and awards for services performed as a nonemployee, other forms of compensation for services performed for your trade or business by an individual who is not your employee. . ." *See* www.irs.gov/instructions/i1099msc/ar02.html#d0e1153.

III. ARGUMENT AND AUTHORITIES.

A. The Court Does Not Have Subject Matter Jurisdiction Because This Action Does Not Involve The Fraudulent Sale Of Securities.

1. Neither the SEC nor the Receiver Has Alleged Facts Sufficient to Establish Subject Matter Jurisdiction.

Dismissal of an action is required under Rule 12(b)(1) if the court lacks subject matter jurisdiction. FED. R. CIV. P. 12(b)(1). Lack of subject matter jurisdiction may be raised by a litigant or questioned by the court at any time. *Mansfield, C. & L.M. R. Co. v. Swan*, 111 U.S. 379, 382 (1884). When a court considers its subject matter jurisdiction, the burden of proof is on the plaintiff. *Adams v. Bain*, 697 F.2d 1213, 1219 (4th Cir. 1982); *see also Kokkonen v. Guardian Life Ins. Co.*, 511 U.S. 375, 377 (1994) ("Federal courts are of limited jurisdiction. . . . It is to be presumed that a cause lies outside this limited jurisdiction, and the burden of establishing the contrary rests on the party asserting jurisdiction.") (citations omitted). In *Richmond, Fredricksburg & Potomac R.R. Co. v. United States*, 945 F.2d 765 (4th Cir. 1991), the Fourth Circuit held:

> In determining whether jurisdiction exists, the district court is to regard the pleadings' allegations as mere evidence on the issue, and may consider evidence outside the pleadings without converting the proceeding to one for summary judgment. The district court should apply the standard applicable to a motion for summary judgment, under which the nonmoving party must set forth specific facts beyond the pleadings to show that a genuine issue of material fact exists. The moving party should prevail only if the material jurisdictional facts are not in dispute and the moving party is entitled to prevail as a matter of law. A district court order dismissing a case on the grounds that the undisputed facts establish a lack of subject matter jurisdiction is a legal determination subject to *de novo* appellate review.

Id. at 768-69 (citations omitted).

In the Complaint in the SEC Matter, the SEC alleged it had statutory authority to bring the action because the defendants in that matter (who are not defendants here) purportedly engaged in a fraudulent scheme that involved the issuance of securities—namely, investment contracts. (SEC Comp., ¶ 1). The defendants in the SEC Matter did not contest the SEC's assertion of federal

subject matter jurisdiction. Instead, they consented to entry of judgment and the appointment of a Receiver at the commencement of the proceeding, and the Court has never addressed whether it has subject matter jurisdiction in the SEC Matter.[5] (SEC Matter, Doc. Nos. 4-8).

The Receiver's authority to bring this claw-back action against the Affiliates derives from the Agreed Order Appointing Temporary Receiver issued in the SEC Matter. (SEC Matter, Doc. No. 4). The Receivership Order was premised on the bare—and to date untested—assertion that the Court had subject matter jurisdiction over the SEC's enforcement action against RVG and Burks. This action, however, cannot proceed because, subject to even modest scrutiny, neither the SEC nor the Receiver has provided an appropriate basis for the Court's jurisdiction over this dispute: neither has established the existence of fraud in connection with a security offering. *See Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 241 (4th Cir. 1988) (stating that "Congress, in enacting the federal securities laws, did not intend to provide a federal remedy for all common law fraud); *Bennett*, 889 F. Supp. at 807) (noting that the federal securities laws do not govern general business frauds, but only frauds that involve transactions relating to the issuance and trading of "securities").

[5] In *SEC v. Bennett*, the SEC filed a complaint and submitted a consent judgment to the district court alleging that the court had subject matter jurisdiction over an alleged Ponzi scheme. The district court, however, was concerned about the unsupported jurisdictional allegations made by the SEC. Before entering the consent judgment, the court required further proof from the SEC: "I therefore deem it appropriate to subject bare jurisdictional allegations in the complaint to slightly more rigorous scrutiny than would otherwise be appropriate, and to require that they be corroborated by affidavit testimony or exhibits submitted by the SEC." *SEC v. Bennett*, 889 F. Supp. 804, 808 (E.D. Penn. 1995). Significantly, one of the Defendants in this matter, Trudy Gilmond, attempted to intervene in the SEC Matter to contest the SEC's jurisdiction and expressly *opposed* the appointment of the Receiver. *See* SEC Matter Doc. No. 84 (Dec. 14, 2012) ("Gilmond Motion"). The Court did not allow Gilmond to intervene, and her jurisdictional challenge was left unresolved. *See* SEC Matter, Doc. No. 151.

2. The ZeekRewards Program Was Not An Investment Contract Under the *Howey* Test.

Section 2(1) of the Securities Act (15 U.S.C. § 77a) and Section 3(10) of the Exchange Act (15 U.S.C. § 78a) defines the term "security," in part, as an "investment contract." While the term "investment contract" is not defined in either the Securities Act or the Exchange Act, the Supreme Court has defined an investment contract as "a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits *solely from the efforts of the promoter or third party*, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." *SEC v. W.J. Howey, Co.*, 328 U.S. 293, 298-99 (1946) (emphasis added); *see also United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975) (noting that the "touchstone" of an investment contract "is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts *of others*.") (emphasis added).

As noted by the Fourth Circuit, "the Supreme Court has endorsed relaxation of the requirement that an investor rely only on others' efforts, by omitting the word 'solely' from its restatement of the *Howey* test." *Robinson v. Glynn*, 349 F.3d 166, 170 (4th Cir. 2003) (citing *Int'l Broth. Of Teamsters v. Daniel*, 439 U.S. 551, 561 (1979)). The Fourth Circuit acknowledged that this was done to avoid excluding "from the protection of the securities laws any agreement that involved even *slight* efforts from investors themselves." *Id.* (emphasis added). The *Robinson* court further stated: "What matters more than the form of an investment scheme is the 'economic reality' that it represents. The question is whether an investor, as a result of the investment agreement itself or the factual circumstances that surround it, is left unable to exercise meaningful control over his investment." *Id. See also Forman*, 421 U.S. at 849 (noting that Congress intended

the application of the Securities Act and Exchange Act "to turn on the *economic realities* underlying a transaction, and not on the name appended thereto.").

Despite the SEC's and Receiver's allegations, RVG did not promote the ZeekRewards program as an investment opportunity, and the Affiliates were not investors. According to the evidence produced by the SEC in response to the Gilmond Motion and cited in Section II above, the ZeekRewards program offered independent professional online marketers an opportunity to "Be Your Own Boss" and earn "income" for "driving traffic" to Zeekler's penny auction website. The program was "designed to be an online-based business" which allowed Affiliates to earn income by "making sales and good old fashioned hard work". Notwithstanding the assertions of the SEC and the Receiver, the Affiliates were essentially independent contractors of ZeekRewards. The evidence submitted by the SEC thus demonstrates that the affiliates were engaged to provide services to support the penny auction website and does not support the SEC's or the Receiver's claim that this matter involves the issuance of securities.

The SEC and the Receiver have simply ignored these facts and mischaracterized this business opportunity as an investment fraud in order to accommodate the SEC's limited statutory authority. They claim that the ZeekRewards program amounted to an investment contract because the Affiliates, at least by design, were entitled to receive profits from the operations of RVG's penny auction business without exerting much effort of their own. (*See* Comp., ¶¶ 73, 77, 79, 87, 89 and 114-17.) There is nothing in the record to support this conclusion, however, and the evidence demonstrates just the opposite: the Affiliates worked hard and performed a number of time consuming tasks to accomplish the job they were paid to do. As reflected in the sworn

statements submitted in the Appendix and summarized in Section II, supra,[6] the Affiliates: (1) drove new customers to the penny auction site (Zeekler.com); (2) promoted the penny auction by placing daily advertisements on the internet; (3) networked with other marketing professionals to gain greater exposure for Zeekler and ZeekRewards; (4) set-up personal websites in an effort to drive traffic to Zeekler and ZeekRewards; (5) recruited customers to the penny auction and new members to ZeekRewards; (6) participated in training programs and leadership calls; and (7) participated in mandatory compliance programs sponsored by ZeekRewards.

As established above: the Moving Defendants worked many hours every day to earn their ZeekRewards income; they considered their work for ZeekRewards their livelihood; their income from RVG/ZeekRewards was their primary source of income; the amount they earned was correlated to how hard they worked; RVG issued forms 1099-MISC to them for the work they performed; and the Moving Defendants paid federal and state taxes on the income they received. These facts belie the Receiver's unsupported allegation that the Affiliates were passive investors who did little to promote RVG or to earn the money they received.

The Moving Defendants (and other Affiliates) *did not*, as required by *Howey*, invest money with the expectation that profits would come solely (or even mostly) from the efforts of others, a necessary requirement to find that an investment contract exists. *Howey*, 328 U.S. at 298. Further, the Moving Defendants and other Affiliates had significant control over their alleged investment and the amount of money they could earn. *Robinson*, 349 F.3d at 170. They put significant

[6] The SEC never contacted any of the Moving Defendants in connection with its investigation of the alleged Ponzi scheme, and the Receiver never interviewed any of the Moving Defendants before filing his action. It is surprising that the government and the Receiver would initiate litigation against potentially thousands of defendants seeking the return of hundreds of millions of dollars without at least inquiring about the role the Affiliates played in promoting RVG's penny auction business.

amounts of time into the program, and the harder they worked, the more income they could earn. They also could have done nothing, which would have had a significant negative effect on their earnings. Accordingly, the Moving Defendants and other Affiliates had near complete control over the financial performance of the resources they committed to RVG. The Affiliates were not passive investors but rather the driving force behind RVG.[7]

Neither the SEC nor the Receiver has produced any evidence to support their theory that the ZeekRewards program constituted an investment contract, and based on the evidence cited above and otherwise contained in the Appendix, it is evident that no "security" was offered to any of the Moving Defendants or to any other Affiliate. Consequently, this matter must be dismissed pursuant to Rule 12(b)(1) for lack of subject matter jurisdiction.

B. The Complaint Fails To State Any Claim For Which Relief Can Be Granted.

1. Standard of review.

In *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), the Supreme Court rejected the rule of *Conley v. Gibson*, 355 U.S. 41 (1957) that a complaint should not be dismissed unless there is no set of facts that could be pleaded that would warrant relief, but the Court was not clear as to whether the new standard signaled a move from notice pleading to fact pleading. In *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) the Court provided clear guidance on the proper standard applicable to a motion to dismiss:

> Under Federal Rule of Civil Procedure 8(a)(2), a pleading must contain a 'short and plain statement of the claim showing that the pleader is entitled to relief.' As the Court held in *Twombly*, the pleading standard Rule 8 announces does not require 'detailed factual allegations,' but it demands more than an unadorned, the-

[7] It makes little sense to assert, as the Receiver does at paragraphs 69 through 74 and 103 of the Complaint, that the Moving Defendants and other Affiliates were, on the one hand, responsible for driving hundreds of millions of dollars to RVG, while, on the other hand, asserting that they did little to earn the income they received. The two notions are incompatible on their face.

> defendant-unlawfully-harmed-me accusation. A pleading that offers 'labels and conclusions' or 'a formulaic recitation of the elements of a cause of action will not do.' Nor does a complaint suffice if it tenders 'naked assertion[s]' devoid of 'further factual enhancement.'
>
> To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged. The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully.

Iqbal, 556 U.S. at 677-678 (citations omitted). The Supreme Court explained that two working principles underlie its decision in *Twombly*: (1) the tenet that a court must accept a complaint's allegations as true is inapplicable to threadbare recitals of a cause of action's elements, supported by mere conclusory statements; and (2) determining whether a complaint states a plausible claim is context-specific, requiring the reviewing court to draw on its experience and common sense. *Iqbal*, 556 U.S. at 663-664 (*citing Twombly*, 550 U.S. at 555-56).

In considering a motion to dismiss, a court may begin by identifying allegations that, because they are mere conclusions, are not entitled to the assumption of truth. *Iqbal*, 556 U.S. at 664. ***Legal conclusions can provide the complaint's framework, but they must be supported by factual allegations.*** *Id.* (Emphasis added.) When a complaint contains well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief. *Id.* As the Fourth Circuit explained in *Francis v. Giacomelli*, 588 F.3d 186, 193 (4th Cir. 2009), "'naked assertions' of wrongdoing necessitate some 'factual enhancement' within the complaint to cross 'the line between possibility and plausibility of entitlement to relief.'"

2. Plaintiff does not have standing under the NCFTA because he is not a "creditor."

Under N.C. GEN. STAT. § 39-23.7, a "creditor" (subject to the limitations in N.C. GEN. STAT. § 39-23.8) has several remedies for relief against a transfer that violates the NCFTA. *See*, N.C. GEN. STAT. § 39-23.7. Plaintiff, however, lacks standing to make a claim under the NCFTA because neither he nor RVG (in whose shoes he stands) is a "creditor." The NCFTA defines a "Creditor" as a person who has a claim (*see*, N.C. GEN. STAT. § 39-23.1(4)) and a "Claim" as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *See*, N.C. GEN. STAT. § 39-23.1(3). The NCFTA also defines a "Debtor" as "a person who is liable on a claim." *See*, N.C. GEN. STAT. § 39-23.1(6).

In North Carolina, it is well settled law that "[w]here the language of a statute is clear and unambiguous, there is no room for judicial construction and the courts must construe the statute using its plain meaning." *Burgess v. Your House of Raleigh, Inc.*, 388 S.E.2d 134, 136 (N.C. 1990) (citation omitted). Based on the definitions set forth in the NCFTA, RVG is not a "creditor" because it has no right to payment from any of the Named Defendants or any other Affiliates. If anything, RVG is a "debtor" because it is liable on claims of the Named Defendants for payments owed to them. Because the Receiver stands in RVG's shoes, he is likewise not a creditor and so lacks standing to make a claim under the NCFTA. In other words, the NCFTA provides a remedy to third parties to a transaction to avoid fraudulent transfers. It provides no remedy to the person who actually made the transfer. *C.f. McLawhorn v. Smith*, 191 S.E. 35 (N.C. 1937) (Where the North Carolina Supreme Court ruled that a deed made with an intent to defraud creditors is valid and enforceable as between grantor and grantee, and is void only as to creditors). Since RVG does

not have standing to make a claim against the Defendants under the NCFTA, Plaintiff, as receiver for RVG, also lacks standing.

3. The Complaint fails to state a claim under the NCFTA.

The Complaint alleges that RVG operated a massive Ponzi scheme (Comp., ¶ 1) and that RVG made numerous profit, commission, bonus and other payments to the Moving Defendants (*Id.*, ¶152). The Complaint characterizes these payments as transfers within the meaning of N.C. GEN. STAT. § 39-23.1(12), claims that the transfers were fraudulent pursuant to N.C. GEN. STAT. § 39-23.4(a)(1), N.C. GEN. STAT. § 39-23.4(a)(2) or N.C. GEN. STAT. § 39-23.5 and claims that they are recoverable from the Moving Defendants pursuant to N.C. GEN. STAT. § 39-23.7 and N.C. GEN. STAT. § 39-23.8. (*Id.*, ¶ 161)

In *Thimbler, Inc. v. Unique Solutions Design, Ltd.*, 2013 WL 4854514 (E.D.N.C. Sept. 11, 2013), Judge Britt held that NCFTA claims in that case had not been pleaded with adequate specificity. In so holding, Judge Britt noted that fraudulent transfer claims must meet not only the pleading requirements of Rule 8 as explained in *Iqbal* and *Twombly* but also the heightened pleading requirements of Rule 9(b) for fraud:

> Furthermore, allegations pertaining to actual fraud are subject to the heightened pleading standard set forth in Rule 9(b) of the Federal Rules of Civil Procedure, which requires that fraud be pled with particularity. *See, e.g., Angell v. C.A. Perry & Son, Inc.* (*In re Tanglewood Farms, Inc. of Elizabeth City*), No. 12–00189–8–JRL, 2013 WL 1405757, at *6 (Bankr. E.D.N.C. Apr. 4, 2013).
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> Under the UFTA, a transfer is actually fraudulent if it is made with the intent to hinder, delay, or defraud a creditor of the debtor. N.C. GEN. STAT. § 39–23.4(a)(1). To set forth a claim for actual fraudulent transfer, Thimbler must state with specificity the factual circumstances constituting the alleged fraud. *See Ivey v. First–Citizens Bank & Trust Co. (In re Whitley)*, No. 12–02028, 2013 WL 486782, at *13 (Bankr. M.D.N.C. Feb. 7, 2013). "Generally, to do this, the complaint must allege (1) the property subject to the transfer, (2) the timing and, if applicable, frequency of the transfers and (3) the consideration paid with respect thereto." *Id.* (stating this rule as applied to the Bankruptcy Code, and noting the "similar[ity] in form and substance," *id.* at *12, to North Carolina's fraudulent transfer statute at N.C. GEN. STAT. § 39–23.4(a)(1)).

Thimbler, Inc., 2013 WL 4854514, at *7; *accord In re Whitley*, 463 B.R. 775, 783-84 (Bankr. M.D.N.C. 2012). In *In re Whitley,* the bankruptcy judge noted that some bankruptcy courts have relaxed the particularity requirements of Rule 9(b) in fraudulent transfer actions. *In re Whitley,* 463 B.R. at 783-84. However, in that case the court found the complaint adequate because it included "particulars as to the identity of the transfers sought to be avoided, including the date, transferor, transferee, method of transfer, and amount of each alleged transfer." *Id.* at 784.

The Receiver specifically alleges that fraudulent transfers were made to the Moving Defendants (Comp., ¶¶ 152-56) and were "made with the actual intent to hinder, delay or defraud some or all of the Receivership Entities' then existing creditors." Additionally, the Receiver makes a claim under to N.C. GEN. STAT. §39-23.4(a)(1), and thus alleges that the transfers were made "[w]ith intent to hinder, delay, or defraud any creditor of the debtor." Plainly, the receiver alleges actual fraudulent intent.

The Complaint in this case is deficient in every respect. It falls short of the Supreme Court's mandate in *Iqbal* because the Receiver makes only "threadbare recitals of" the elements of a NCFTA claim "supported by mere conclusory statements;" thus the Complaint fails to meet even the minimal pleading requirements of Rule 8. Moreover, because the Complaint alleges fraudulent intent, the Receiver was required to meet the heightened pleading requirements of Rule 9. In that regard, at a minimum, the Receiver should have included "particulars as to the identity of the transfers sought to be avoided, including the date, transferor, transferee, method of transfer, and amount of each alleged transfer" (*In re Whitley,* 463 B.R. at 783-84) and the consideration exchanged for the transfer (*Thimbler, Inc.*, 2013 WL 4854514 at *7), but he did not. Indeed, the Receiver makes not a single specific allegation about any transfers to any of the Moving Defendants.

Eighteen months passed between the date the Receiver was appointed in the SEC Matter and the date he filed the Complaint. During that time, the Receiver sought and received compensation in excess of $7 million for his investigation into the alleged RVG Ponzi scheme. (SEC Matter, Doc. No. 209 (Application for Fees and Expenses by the Receiver and his Advisors for the First Quarter of 2014, p. 3).) A significant portion of the compensation was for alleged forensic work by FTI. After 18 months of investigation and millions of dollars in fees, the Receiver should have had sufficient information to plead the particulars as to the identity of the transfers he claims were fraudulent, including the date, transferor, transferee, method of transfer, the amount of each alleged transfer and the consideration exchanged for the transfer, but he failed to do so. Certainly the Receiver, a well-respected attorney at an international law firm, is charged with knowledge of the pleading requirements in fraudulent transfer actions. For those reasons, the First Claim for Relief in the Complaint should be dismissed with prejudice. If it is not, then the Court should give the Receiver one opportunity to amend to plead with the specificity required as to each of the Moving Defendants.

4. The Second Claim For Relief (Common Law Fraudulent Transfer) should be dismissed with prejudice because the claim does not exist in North Carolina.

In paragraphs 163 through 172 of the Complaint, the Receiver purports to state claims against the Moving Defendants for common law fraudulent transfer. As a threshold matter, the claim is deficient and fails for the same reasons the Receiver's first claim for relief fails—an overabundance of generality and a gross lack of specificity. More fundamentally, however, the claim fails because it does not exist in North Carolina.[8]

[8] The Receiver does not identify which state's common-law he seeks to apply, but inasmuch as there is no federal common law (*Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938) ("There is no federal general common

North Carolina adopted the Uniform Fraudulent Transfer Act (N.C. GEN. STAT. §§ 39-23.1-3923.12) in 1997. In conjunction with the enactment of the NCFTA, the legislature repealed N.C. GEN. STAT. §§ 39-15 and 39-16, which embodied North Carolina's enactment of the Statutes of 13 and 27 Elizabeth, respectively. *See The Law of Fraudulent Conveyances in North Carolina: An Analysis and Comparison with the Uniform Fraudulent Conveyances Act*, 50 N.C. L. Rev. 873, 874 (1971-1972). By the Statutes of 13 and 27 Elizabeth "conveyances made with intent to hinder, delay, or defraud creditors [were] declared to be utterly void and of no effect." *Cox v. Wall & Huske*, 44 S.E. 635, 636 (N.C. 1903). As the North Carolina Supreme Court noted in *Cox*, and citing the North Carolina Code of 1883 §§ 1545-48, North Carolina codified laws against fraudulent conveyances as early as 1883. *Cox*, 44 S.E. at 635.

In *Cox*, discussing the appropriate placement of the burden of proof with respect to one's status as an innocent purchaser, the Supreme Court cited authorities from other jurisdictions but then noted:

> The solution of this question depends somewhat upon the phraseology of the statute against fraudulent conveyances, and *the decisions of the courts of other states and any rule which may be supposed to have prevailed at common law cannot be safely followed, as our statute is not in all respects like the statutes of other states, or in strict accordance with the common-law principle.* The rules of evidence, including the burden of proof, to be applied in the trial of a case, are a part of the law of the remedy, and will be supplied by the *lex fori*, especially when the cause of action is founded upon a local statute. We must follow our own decisions upon the subject.

Cox, 44 S.E. at 638 (emphasis added). Thus, the North Carolina Supreme Court recognized as early as 1903 that claims of fraudulent conveyance in North Carolina were governed by statute, not common law.

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law")), the Receiver invokes the law of North Carolina for his first claim for relief, and he alleges that RVG was headquartered here, the Moving Defendants assume that the Receiver relies on North Carolina law.

In sum: (i) North Carolina has had fraudulent conveyance statutes on the books since at least 1883; (ii) the North Carolina Supreme Court recognized in 1903 that fraudulent conveyance claims in North Carolina were governed by statute, not common law; and (iii) in 1997, the State enacted the NCFTA, which is a comprehensive framework of law applicable to fraudulent transfers. The NCFTA specifically provides that it "shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this Article among states enacting it." That statement alone is sufficient for the Court to determine that, if there was a common-law claim for fraudulent conveyance prior to 1997, it was eradicated thereafter by the enactment of the NCFTA so that North Carolina's law would be consistent with the laws of other states. Further, the NCFTA provides:

> Unless displaced by the provisions of this Article, the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency, or other validating or invalidating cause, supplement its provisions.

N.C. GEN. STAT. §§ 39-23.10. Significantly, this section does not mention retaining any principles of common law fraudulent transfers in North Carolina.

In *Moore v. Browning*, 203 Ariz. 102, 50 P.3d 852 (Ct. App. 2002), the Arizona Court of Appeals was called on to determine whether a claim for common law fraudulent transfers existed in Arizona, which, like North Carolina, has adopted the Uniform Fraudulent Transfer Act. Undertaking an analysis similar to that set forth above, the Arizona court wrote:

> We find it more helpful to consider the effect of Arizona's adoption of UFTA on any common law cause of action for fraudulent conveyance that might have survived its enactment. In addition to providing comprehensive remedies for all creditors unable to collect from debtors who have fraudulently conveyed their assets, UFTA expressly applies to all types of properties, conveyances, and rights to payment. § 44–1001. The Act governs transfers fraudulent as to both present and future creditors, defines when a transfer has been made or an obligation incurred, and establishes what constitutes adequate value for a transfer. §§ 44–1004, 44–1006, and 44–1003. Finally, the Act enumerates available defenses, states the kinds

> of transferees against whom a creditor may obtain judgment, and adopts a statute of limitations expressly tailored for fraudulent transfers. §§ 44–1008 and 44–1009.¶ 19. The Act also provides: 'Unless displaced by the provisions of this article, the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency or other validating or invalidating clause, supplement its provisions.' § 44–1010; . . . We find it notable that § 44–1010 does not mention retaining any principles of the common law of fraudulent conveyance.
>
> But, most telling, the Ulans have nowhere cited any case setting out the elements of and rules applicable to a common law cause of action for fraudulent conveyance.

Moore, 203 Ariz. at 107, 50 P.3d at 857. The Moore court concluded: "Considering the legal history and the Ulans' authorities, we conclude that UFTA has displaced any common law cause of action for fraudulent conveyance and find that the respondent judge erred in concluding otherwise." *Moore*, 203 Ariz. at 108, 50 P.3d at 858.

Dismissal under Rule 12(b)(6) is appropriate where the complaint lacks a cognizable legal theory or sufficient facts to support a cognizable legal theory. *Murphy-Taylor v. Hofmann*, 968 F. Supp. 2d 693, 710 (D. Md. 2013), citing *Hartmann v. Calif. Dept. of Corr. & Rehab*., 707 F.3d 1114, 1122 (9th Cir. 2013) and *Commonwealth Prop. Advocates, LLC v. Mortg. Elec. Reg. Sys., Inc.*, 680 F.3d 1194, 1201–02 (10th Cir. 2011). Because there is no cognizable claim for common law fraudulent transfer, the Second Claim for Relief should be dismissed with prejudice.[9]

5. The Complaint fails to state a claim for constructive trust.

The Receiver designates the Third Claim for Relief in the Complaint as one for "Constructive Trust." This claim fails because "constructive trust" is an equitable remedy, not a

[9] In Paragraph 172 of the Complaint, the Receiver alleges: "Accordingly, pursuant to 28 U.S.C. § 2201, the Receiver is entitled to a Judgment: (1) avoiding the Transfers; and (2) recovering the Transfers, or the value thereof, from the Defendants and the members of the Net Winner Class for the benefit of the Receivership Estate." 28 U.S.C. § 2201 is the federal declaratory judgment act. It is unclear to the Moving Defendants what relevance that citation has to any facts in the Complaint, particularly since the Receiver makes no request for a declaration of the parties' rights.

cause of action, and because the Receiver has failed to plead any facts that would warrant the equitable remedy of constructive trust as against the Moving Defendants.

In *Weatherford v. Keenan*, 493 S.E.2d 812 (N.C. App. 1997), the defendant complained on appeal that it was error for the trial court to make findings regarding constructive trust when plaintiff had not pleaded constructive trust. The court of appeals rejected defendant's argument:

> *Defendant errs when he suggests that a constructive trust is a cause of action rather than a remedy. When a court impresses a constructive trust upon property for the benefit of a claimant, it exercises its equitable powers to fashion remedies.* See *Roper v. Edwards*, 323 N.C. 461, 465, 373 S.E.2d 423, 425 (1988) (" 'On the whole ... the constructive trust is seen by American courts today as a remedial device, to be used wherever specific restitution in equity is appropriate on the facts.' " (quoting D. Dobbs, Remedies § 4.3 (1973))). It is true that a claimant may expressly sue to establish a constructive trust, based on a legal theory justifying its creation. It is not necessary, however, for a claimant to expressly seek the creation of a constructive trust for a court to do equity.

Weatherford, 493 S.E.2d at 813 (emphasis added); *accord New Amsterdam Cas. Co. v. Waller*, 301 F.2d 839, 842 (4th Cir. 1962) ("A constructive trust is merely a procedural device by which a court of equity may rectify certain wrongs. It is suggestive of a power which a court of equity may exercise in an appropriate case, but it is not a designation of the cause of action which justifies an exercise of the power."); *WJ Global LLC v. Farrell*, 941 F. Supp. 2d 688, 693 (E.D.N.C. 2013) ("Though plaintiff's complaint denominates a claim for constructive trust, a claim for constructive trust is properly denominated as a remedy for a claim of unjust enrichment.")

Even if the Court construes the Complaint as seeking the remedy of constructive trust rather than as setting forth a claim for constructive trust, the Receiver has failed to plead any facts from which the Court can infer that a constructive trust is an appropriate remedy as to the Moving Defendants. As the North Carolina Supreme Court noted in *Wilson v. Crab Orchard Development Co.*, 171 S.E.2d 873 (N.C. 1970):

> A constructive trust is a duty, or relationship, imposed by courts of equity to prevent the unjust enrichment of the holder of title to, or of an interest in, property *which such holder acquired through fraud, breach of duty or some other circumstance making it inequitable for him to retain it against the claim of the beneficiary of the constructive trust.* . . . [A] constructive trust is a fiction of equity, brought into operation to prevent unjust enrichment through the breach of some duty or other wrongdoing. It is an obligation or relationship imposed irrespective of the intent with which such party acquired the property, and in a well-nigh unlimited variety of situations. *Nevertheless, there is a common, indispensable element in the many types of situations out of which a constructive trust is deemed to arise. This common element is some fraud, breach of duty or other wrongdoing by the holder of the property, or by one under whom he claims, the holder, himself, not being a bona fide purchaser for value.*

Wilson, 171 S.E.2d at 882 (citations omitted). In *In re Magna Corp*., 2003 WL 22078082 (Bankr. M.D.N.C. Aug. 29, 2003), the bankruptcy judge commented about the imposition of constructive trusts as follows:

> A review of the North Carolina cases reflects that the standards for the imposition of a constructive trust are stated in broad, general terms and that the cases are very fact specific and result driven. *Although some type of misconduct or the violation of a fiduciary duty by the defendant is required*, actual fraud is not required in order for a constructive trust to be imposed.

In re Magna Corp., 2003 WL 22078082, at *5 (emphasis added), citing *Roper v. Edwards*, 373 S.E.2d 423, 425 (N.C. 1988), and *Leatherman v. Leatherman*, 256 S.E.2d 793, 795-96 (N.C. 1979).

The Receiver has failed to make any claims in equity justifying the imposition of a constructive trust, and he has failed to allege any facts from which the court can draw an inference that the imposition of a constructive trust against assets of the Moving Defendants is appropriate. While the Receiver alleges that Burks and the other Insiders knew they were running a Ponzi scheme (*see* Comp., ¶¶ 72, 85, 92, 101), he has not alleged that any of the Named Defendants knew that RVG/ZeekRewards was a Ponzi scheme. For example, the Receiver alleges at paragraph 174 of the Complaint that "the assets of the Receivership Entities have been wrongfully diverted as a result of fraudulent transfers to the Defendants and the Net

Winner Class for their individual interests and enrichment," but he fails to allege any misconduct by any of the Moving Defendants and fails to allege any facts from which the Court can conclude that the Moving Defendants are anything other than persons who accepted their earnings in good faith and for value. *Wilson*, 171 S.E.2d at 882.

Moreover, the North Carolina case law is clear that a constructive trust is an equitable remedy that is only available if there is no adequate legal remedy. *In re Gertzman*, 446 S.E.2d 130, 135 (N.C. App. 1994) ("A constructive trust does not arise where there is no fiduciary relationship and there is an adequate remedy at law."), citing *Security National Bank of Greensboro v. Educators Mutual Life Insurance Co.*, 143 S.E.2d 270, 276 (N.C. 1965). While the Receiver states that he has "no adequate remedy at law" (Comp., ¶ 175), he wholly fails to plead any facts to support that naked legal conclusion. *Iqbal*, 556 U.S. at 664 ("[L]egal conclusions can provide the complaint's framework, but they must be supported by factual allegations.")

For these reasons, the Court should dismiss the Complaint's Third Claim for Relief.

IV. CONCLUSION

WHEREFORE, Defendants respectfully request that the Court dismiss the Complaint in its entirety.

This 30th day of June, 2014.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing **MEMORANDUM IN SUPPORT OF DEFENDANTS' JOINT MOTIONS TO DISMISS PURSUANT TO RULES 12(b)(1) AND 12(b)(6)** with the Clerk of Court using the CM/ECF system which will send notification of such filing to the following and to other CM\ECF registered users who have requested such notice:

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This the 30th day of June, 2014.

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