IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION (DAYTON)

CYNTHIA BOYD, et al.,	:	**CASE NO. 3:16-CV-00009**
Plaintiff,	:	**Judge Thomas Rose**
V.	:	
THE KINGDOM TRUST COMPANY, et al.,	:	**MEMORANDUM IN OPPOSITION TO PENSCO TRUST COMPANY, LLC'S MOTION TO DISMISS**
Defendants.	:	

I. INTRODUCTION[1]

For years Defendant PENSCO Trust Company, LLC oversaw and orchestrated the sale, by William Apostelos and his cronies, of illegal securities to unsuspecting victims as part of a Ponzi scheme. Indeed, PENSCO played an integral role in each sale to a PENSCO account holder. The sale of the securities to PENSCO account holders could not have happened unless the unsuspecting victims first jumped through the many hoops required by PENSCO to consummate the sales. And PENSCO profited from the illegal sales.

Confronted now with its role in a devastating Ponzi scheme costing investors millions, PENSCO looks to shed its responsibility for the harm it facilitated. Rather than own up to its violations of Ohio's securities laws, PENSCO asks the Court to dismiss the Complaint, claiming the law does not apply to PENSCO. Although PENSCO fits squarely within the cross-hairs of Ohio law imposing liability on companies participating in or aiding in any way with the sale of illegal securities, PENSCO asks this Court to carve out an exemption for its conduct.

[1] Mr. Flanders disagrees oral argument is required; this case is not so factually and legally complex as to justify an exception to this Court's traditional rule of not setting motions for summary judgment. (*See* L.R. 7.1(b)(2)).

Fortunately for Mr. Flanders, the potential class participants, and the rest of the investing public, Ohio securities law is clear – PENSCO is not above the law and, as detailed in the complaint, must be held accountable for the exploitation of victims.

II. BACKGROUND AND FACTS IN THE COMPLAINT

For more than four years, Apostelos and his accomplices executed a Ponzi scheme. The scheme resulted in more than 350 victims investing in excess of $66.7 million. (ECF No. 1, PageID 2, ¶ 1). To facilitate the scheme, Apostelos had Plaintiff, Tom Flanders, transfer his individual retirement account ("IRA") to PENSCO, a self-directed investment retirement account custodian. (*Id*. at 2-3, ¶ 4).[2] Apostelos and/or his associates, on behalf of PENSCO, assisted Mr. Flanders in executing the documents necessary to transfer custodial responsibility for his IRA to PENSCO. (*Id*. at 14, ¶ 61). On February 25, 2011, PENSCO, on behalf of Mr. Flanders, bought illegal securities from Apostelos. PENSCO paid $497,000 for the securities, (*id*. at 15, ¶ 62), and collected fees from Mr. Flanders related to the execution of the sale. (*Id*. at 10, ¶ 42).

The consummation of the sale of the securities with Mr. Flanders' IRA assets could not have occurred without PENSCO's participation in and execution of the sale. That is, without PENSCO's assistance with and participation in the sale of the illegal securities, Apostelos would not have been able to complete the sale of securities to Plaintiffs. (*Id*. at 12, ¶ 49). On this point, before the securities could be sold to Mr. Flanders, PENSCO had certain requirements that had to be met. (*Id*., ¶ 50). These pre-sale dictates included mandating the execution of an Unsecured Note Investment Authorization Form; mandating the execution of a Loan Servicing Agreement; requiring the lender's name on the promissory note to read "PENSCO Trust Company,

[2] PENSCO devotes much of its recitation of facts to describing itself as a Self Directed IRA ("SDIRA") custodian and references both IRS regulations as well as an SEC investor alert regarding Self Directed IRAs. PENSCO's role as an SDIRA custodian is not called into dispute by the complaint. However, nothing in the IRS code or the SEC Alert obviates PENSCO's responsibilities and liabilities under the Ohio Securities Act.

Custodian FBO (Client Name) IRA"; requiring the lender's address be listed as "PO Box 173859, Denver, CO 80217" (PENSCO's address); any promissory note had to have a maturity date no longer than 10 years from the date of the note; a copy of the executed promissory note had to be provided to PENSCO before PENSCO would fund the sale; the original note had to be provided to PENSCO after PENSCO funded the sale; Articles of Incorporation or Operating Agreement/Private Placement Memorandum for borrower (*e.g*. one of Apostelos' companies) had to be given to PENSCO; Certificate of Good Standing for borrower (*e.g*. one of Apostelos' companies) had to be given to PENSCO; Amortization or Payment Schedule had to be given to PENSCO; and the original note with a notarized signature by the borrower (*e.g*. Apostelos) had to be given to PENSCO before PENSCO would fund the sale. (*Id*. at 12-13, ¶¶ 51-52). Once all of the prerequisites dictated by PENSCO were met for the sale of the illegal securities, PENSCO then funded the sale with cash from Mr. Flanders' account and thereafter took title, custody and possession of the illegal securities. (*Id*. at 11, ¶ 47).

As a result of the fraudulent scheme aided by PENSCO, the illegal securities sold are worthless and Mr. Flanders has lost all or substantially all of the balance of his IRA. (*Id*. at 15, ¶ 64). Mr. Flanders, personally and on behalf of other victims who had PENSCO accounts, filed this action seeking to hold PENSCO liable for its role in the sale. More specifically, in accordance with Section 1707.43(A) of the Ohio Securities Act, Mr. Flanders has elected to void the sale of the securities and is seeking recovery from PENSCO because it participated in or aided Apostelos in making the sale. PENSCO filed the instant motion arguing it cannot be liable because it only engaged in "routine" or "normal banking activities", it did not aid Apostelos, PENSCO's communications with Apostelos were on behalf of Mr. Flanders and Apostelos was

not acting on behalf of PENSCO, and PENSCO should be included in exemptions to Section 1707.43. (ECF No. 10, PageID 65-73).

III. THE STATUTE AT ISSUE HERE – THE OHIO SECURITIES ACT

PENSCO did not acknowledge in its motion how broadly courts, including this one, have nearly universally construed Ohio's securities laws. So before turning to the specific arguments for dismissal made by PENSCO, it is important to consider the expansive reach of the Ohio Securities Act, including the primary section at issue here.

> Chapter 1707 of the Ohio Revised Code [aka 'Ohio's Securities Act' or 'Ohio's Blue Sky laws'] governs the sale and purchase of securities in Ohio. Its purpose is 'to prevent the fraudulent exploitation of the investing public through the sale of securities.' *In re Columbus Skyline Securities, Inc.*, 74 Ohio St.3d 495, 498, 1996 Ohio 151, 660 N.E.2d 427, 429 (Ohio 1996). The Ohio Securities Act requires securities to be registered and salespersons and dealers to be licensed, and it proscribes fraudulent conduct. *See* O.R.C. §§ 1707.08 - 1707.13 (registration); §§ 1707.14 - 1707.19 (licensing); §§ 1707.41, 1707.44 (proscribing fraud). Courts have liberally construed the Act to effectuate its remedial purpose. *See, e.g., In re Columbus Skyline*, 74 Ohio St.3d at 498, 660 N.E.2d at 429; *Federated Mgmt. Co. v. Coopers & Lybrand*, 137 Ohio App.3d 366, 391, 738 N.E.2d 842, 860-61 (Ohio Ct. App. 2000).

In re Nat'l Century Fin. Enters., Inc., 755 F.Supp.2d 857, 873 (S.D.Ohio 2010).

Indeed, "[m]any of the enacted [securities] statutes are remedial in nature, and have been drafted broadly to protect the investing public…", *see Bronaugh v. R. & E. Dredging Co.*, 16 Ohio St.2d 35, 242 N.E.2d 572 (1968), and, "[i]n order to further the intended purpose of the Act, its securities anti-fraud provisions must be liberally construed." *In re Columbus Skyline*, 74 Ohio St.3d at 498.

Here, Mr. Flanders alleges he was sold unregistered securities by Apostelos who was not licensed to sell securities. (ECF No. 1, PageID 17, ¶¶ 73-76). The sale of securities to Mr.

Flanders violated Ohio's Securities Act. (*Id*. at 18, ¶ 77). Apostelos is, therefore, liable to Mr. Flanders for the illegal sale. But Ohio securities law does not limit liability for the illegal sale of securities to just the primary actor. Secondary liability can be extended to others. Section 1707.43(A) of the Ohio Securities Act, entitled "Remedies of purchaser for unlawful sale", provides in pertinent part:

> (A) Subject to divisions (B) and (C) of this section, every sale or contract for sale made in violation of Chapter 1707 of the Revised code, is voidable at the election of the purchaser. The person making such sale or contract for sale, and every person that has **participated in or aided the seller in any way** in making such sale or contract for sale, are jointly and severally liable to the purchaser…. (emphasis added).

This court recently explained the broad scope of Section 1707.43. In *In re Nat'l Century*, 755 F.Supp.2d at 884-885, Judge Graham held:

> A secondary actor need not commit fraud to be liable; the secondary actor need only participate in or aid the sales transaction. Joint and several liability extends to "every person that has participated in or aided the seller in any way in making such sale or contract for sale." O.R.C. § 1707.43(A). The statute does not require knowledge, intent, or any other mental state on the part of secondary actor, nor does it require reliance, inducement, or proximate cause as between the secondary actor and purchaser. *See Nickels v. Koehler Mgmt. Corp*., 541 F.2d 611, 616 (6th Cir. 1976) (noting that rescission is available under § 1707.43 "without a showing of reliance"); *Federated*, 137 Ohio App.3d at 391, 738 N.E.2d at 861 ("R.C. 1707.43 does not require that a person induce a purchaser to invest in order to be held liable. Rather, the language is very broad, and participating in the sale or aiding the seller in any way is sufficient to form a basis for liability under R.C. 1707.43.").
>
> The statute simply requires an act of participation or assistance in the sale and some form of remuneration, either direct or indirect. *See* O.R.C. § 1707.431(B) (remuneration requirement, which is waived for investment advisers). Indeed, one Ohio court has referred to the statute as creating a strict liability standard. *Ryan v. Ambrosio*, 2008 Ohio 6646, 2008 WL 5258308, at *4 (Ohio Ct. App. 2008)…Courts have held that § 1707.43 imposes liability on

> persons who introduce investment opportunities, serve as conduits of information, act as intermediaries in the exchange of money and securities, and arrange meetings between buyers and sellers. *See, e.g., Johnson v. Church of the Open Door*, 179 Ohio App.3d 532, 541, 2008 Ohio 6054, 902 N.E. 2d 1002, 1009 (Ohio Ct. App. 2008); *Boland v. Hammond*, 144 Ohio App.3d 89, 94, 2001 Ohio 2680, 759 N.E.2d 789, 793 (Ohio Ct. App. 2001); *Perkowski v. Megas Corp.*, 55 Ohio App.3d 234, 235, 563 N.E.2d 378, 379 (Ohio Ct. App. 1990); *Gerlach v. Wergowski*, 65 Ohio App.3d 510, 514, 584 N.E.2d 1220, 1222 (Ohio Ct. App. 1989).
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> Ohio's imposition of secondary liability thus targets the sales transaction….

In addition, in analyzing the broad protections given the investing public, this court also held, "'[i]t must be emphasized that R.C. 1707.43 uses very broad language'", *In re Nat'l Century Fin. Enters., Inv. Litig.*, 504 F.Supp.2d 287, 307-308 (S.D.Ohio 2007), quoting *Federated Mgmt.*, 137 Ohio App. 3d at 392, and the language "participated in or aided the seller in any way" is "broad in scope and extends beyond the actual seller and issuer of the security." *Escue v. Sequent, Inc.*, S.D.Ohio No. 2:09-cv-765, 2010 U.S. Dist. LEXIS 87043, at *39-42 (Aug. 24, 2010), relying upon *Federated Mgmt.*, 137 Ohio App.3d at 391.

Further still, because Section 1707.43 is a remedial statute, as with other remedial statutes, "[f]ollowing traditional canons of statutory interpretation, [it] should be construed broadly to extend coverage and [its] exclusions or exceptions should be construed narrowly." *Passa v. City of Columbus*, S.D.Ohio No. 2:03-CV-81, 2007 U.S. Dist. LEXIS 78905, at *18-21 (Oct. 24, 2007), citing *Cobb v. Contract Transport, Inc.*, 452 F.3d 543, 559 (6th Cir. 2006). *See also Wukelic v. United States*, 544 F.2d 285, 288 (6th Cir. 1976) (holding remedial statutes must be "construed liberally" and "exceptions… should be construed narrowly."). The application of Section 1707.43 begins and ends with its plain wording. *See, e.g., Brilliance Audio, Inc. v. Haights Cross Commc'n, Inc.*, 474 F.3d 365, 371 (6th Cir. 2007) ("As with any question of

statutory interpretation, we must first look to the language of the statute itself."); *Pittsburgh & Conneaut Dock Co. v. Director, Office of Workers' Compensation Programs*, 473 F.3d 253, 266 (6th Cir. 2007) ("In all cases of statutory construction, the starting point is the language employed by [the legislature] . . . [and] where the statute's language is plain, the sole function of the courts is to enforce it according to its terms.") (citing *Appleton v. First Nat'l Bank of Ohio*, 62 F.3d 791, 801 (6th Cir. 1995) (internal quotation marks omitted)); *Limited, Inc. v. C.I.R.*, 286 F.3d 324, 332 (6th Cir. 2002) ("[W]e look first to the plain language of the statute.").

With the operative statute put in proper context, PENSCO's erroneous pleas for dismissal are considered.

IV. ARGUMENT

In deciding a motion to dismiss for failure to state a claim under Rule 12(b)(6), courts must "construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff." *DirecTV, Inc. v. Treesh*, 487 F.3d 471, 476 (6th Cir. 2007); *Coley v. Lucas Cnty.*, 799 F.3d 530, 537 (6th Cir. 2015); *Miller v. Franklin Cnty. Children Servs.*, S.D.Ohio No. 2:15-cv-179, 2016 U.S. Dist. LEXIS 7698, at *14 (Jan. 22, 2016). To survive a motion to dismiss, the "complaint must contain either direct or inferential allegations with respect to all material elements necessary to sustain recovery under some viable legal theory." *Mezibov v. Allen*, 411 F.3d 712, 716 (6th Cir. 2005).

Contrary to PENSCO's suggestion, there is no heightened pleading standard applicable here as notice pleading is the requirement of Federal Rule of Civil Procedure 8(a)(2).

> Federal Rule of Civil Procedure 8(a)(2) requires only 'a short and plain statement of the claim showing that the pleader is entitled to relief' in order to 'give the defendant fair notice of what the … claim is and the grounds upon which it rests' …. [A] complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations.

Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555, 127 S.Ct. 1955 (2007) (internal citations omitted); *see also Ashcroft v. Iqbal*, 556 U.S. 662, 677-678, 129 S.Ct. 1937 (2009); *Coley*, 799 F.3d at 544; *Jones v. Praxair, Inc.*, S.D.Ohio No. 3:15cv00277, 2016 U.S. Dist. LEXIS 28808, at *2 (Mar. 7, 2016) ("Notice pleading is alive in the United States Courts"); Fed. R. Civ. P. 8(a)(2). Furthermore, courts do not require plaintiffs to conduct extensive pre-complaint discovery. Instead, they look for the "reasonable expectation that discovery will reveal" sufficient evidence. *Twombly*, 550 U.S. at 556; *Tam Travel v. Delta Airlines*, 583 F.3d 896, 903 (6th Cir. 2009); *Lovett v. Barney*, S.D.Ohio No. 1:15-cv-24, 2015 U.S. Dist. LEXIS 102799, at *15 (Aug. 5, 2015).

As PENSCO notes, in considering whether a complaint contains sufficient allegations to withstand scrutiny, the court should "'draw on its judicial experience and common sense' to determine that the well-pleaded facts provide more than a mere possibility of misconduct." (ECF No. 10, PageID 65) (*quoting Iqbal*, 556 U.S. at 679). Nonetheless, "of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable and 'that a recovery is very remote and unlikely.'" *Twombly*, 550 U.S. at 556 (internal citation omitted); *Stratton v. Portfolio Recovery Assoc.*, 770 F.3d 443, 447 (6th Cir. 2014); *R&L Carriers, Inc. v. Affiliated Computer Servs. (In re Bill of Lading Transmission & Processing Sys. Patent Litig.)*, S.D.Ohio, 2010 U.S. Dist. LEXIS 144593, at *37-38 (July 15, 2010). Moreover, the plausibility standard set forth by PENSCO "is not akin to a 'probability requirement,' but [instead] asks for more than a sheer possibility that a defendant has acted unlawfully." *Iqbal*, 556 U.S. at 678; *Jones*, 2016 U.S. Dist. LEXIS 28809 at *4 (quoting *Iqbal*, 556 U.S. at 678); *see also Fortkamp v. ABN Amro Mortg. Grp.*, S.D.Ohio No. 3:14-cv-458, 2015 U.S. Dist. LEXIS 29923, at *6 (Mar. 11, 2015) ("*Iqbal* thus held that *Twombly's* plausibility

standard did not significantly alter notice pleading or impose heightened pleading requirements," quoting *Weisbarth v. Geauga Park Dist.*, 499 F.3d 538, 542 (6th Cir. 2007)). "The defendant has the burden to show that the plaintiff failed to state a claim for relief." *Coley*, 799 F.3d at 537; *see also Mediacom Southeast v. BellSouth Telcoms.*, 672 F.3d 396, 399 (6th Cir. 2012).

Finally, with respect to claims brought under Section 1707.43, "the Ohio statute does not carry a heightened pleading standard, nor is it accompanied by a body of law…requiring particularized allegations of involvement…" *In re Nat'l Century Fin.*, 504 F.Supp.2d at 307-308. This is in part because Ohio's securities laws are required to be liberally construed. *Id*.

A. Mr. Flanders has properly alleged PENSCO participated in or aided in any way Apostelos in the sale of securities in violation of Section 1707.43.

PENSCO claims the "sole operative allegation" against it is that, but for PENSCO's services, Apostelos would not have been able to sell the securities to Plaintiffs. (ECF No. 10, PageID 63). If this was indeed the only allegation against PENSCO, it would by itself be sufficient to overcome PENSCO's motion. But this is not the only allegation relating to PENSCO's conduct. The Complaint thoroughly details how PENSCO participated in or aided in any way the sale of the securities and far exceeds the low threshold for the Court to find Mr. Flanders' alleged facts supporting a viable legal theory and PENSCO has failed to carry its burden.

PENSCO ignores much of the Complaint in claiming there is a single "operative allegation." More specifically, the Complaint states:

- Mr. Flanders had assets in a traditional, non self-directed IRA account. Custodians of traditional IRA accounts do not allow assets held in accounts over which they are custodians to be used for the purchase of the illegal securities. So Apostelos had to use the services of IRA custodians like PENSCO that would allow the use of IRA funds for the purchase of the illegal securities. (ECF No. 1, PageID 9-10, ¶¶ 39, 41).

- PENSCO knew Apostelos was operating in Ohio and that he was soliciting investors in Ohio. PENSCO agreed to provide services to investors in Ohio, including Mr. Flanders, who would purchase securities from Apostelos with the aid and participation of PENSCO. (*Id*. at 4-5, ¶ 17).

- Apostelos, acting on behalf of PENSCO, assisted Mr. Flanders in executing the necessary documents to transfer his IRA to PENSCO. (*Id*. at 14, ¶ 61).

- PENSCO opened an IRA account for Mr. Flanders, accepted his retirement funds, and transmitted account information for Mr. Flanders and/or persons or companies associated with Apostelos. (*Id*. at 11, ¶ 47).

- PENSCO took title, custody and possession of all of the assets in Mr. Flanders' accounts. (*Id*.).

- PENSCO acted as an intermediary for the sale of the securities to Mr. Flanders. Mr. Flanders transmitted money to PENSCO; PENSCO transmitted the money to Apostelos; in return, PENSCO received and took custody of the securities. (*Id*. at 4-5, 15, ¶¶ 17, 62).

- PENSCO's experts reviewed each new transaction, including the sale of illegal securities to Mr. Flanders. (*Id*. at 10-11, ¶ 44).

- The sale of the illegal securities to Mr. Flanders could not have happened without PENSCO's participation in and execution of the transaction. (*Id*. at 12, 18, ¶¶ 49, 81).

- PENSCO had specific requirements for the sale of the illegal securities to Mr. Flanders before PENSCO would consummate the sale. (*Id*. at 12, ¶ 50).

- PENSCO required it be listed as the lender on the securities sold to Mr. Flanders. (*Id*., ¶ 51).

- PENSCO also required receipt of a copy of the executed promissory note, the original note, a subscription agreement completed and executed by the Account Owner, the Articles of Incorporation for the borrower, a certificate of good standing for the borrower, amortization schedule and the original notarized note. (*Id*. at 12-13, ¶ 52).

- PENSCO profited by charging fees to Mr. Flanders related to his account and the execution of the transaction involving the sale of the unregistered securities. (*Id*. at 4, 10, ¶¶ 16, 42).

In short, Mr. Flanders clearly alleges PENSCO actively participated in or aided in any way the sale of the unregistered securities.

Despite this plethora of alleged facts demonstrating its role in the sale, PENSCO asks the Court to decide Ohio cases have defined an exhaustive list of factors considered to determine participation in or aid of the sale of a security. (ECF No. 10, PageID 69-70). While Ohio "courts have considered several factors in deciding whether a person or entity shall be responsible for the sale of illegal securities under R.C. 1707.43(A)," the factors considered to date are not comprehensive. Whether a defendant participated or aided in any way in the sale of securities is of course fact sensitive as demonstrated by the fact the Ohio Legislature did not define necessary conduct in the statute.

PENSCO nevertheless contends its conduct does not fall within one of these factors (a contention that is not true)[3], so it claims it cannot be found to have violated Section 1707.43. PENSCO ignores that the exact role it played in the sale of securities to Mr. Flanders has been found to be sufficient to state a claim under the statute. *See Hardin v. Reliance Trust Co.*, N.D.Ohio No. 1:04 CV 02079, 2006 U.S. Dist. LEXIS 70822 (Sep. 28, 2006). The defendant in *Hardin* was Reliance Trust Company ("RTC"), a self-directed IRA custodian exactly like PENSCO. Like Mr. Flanders here, the plaintiffs in *Hardin* opened self-directed IRA accounts making RTC the custodian holding their investments. And like Mr. Flanders here, with the aid

[3] For example, the Complaint alleges that PENSCO relayed information directly to, and received information directly from, the seller about the securities at issue. Specifically, the complaint alleges "[t]he purchase of Unregistered Securities with Plaintiffs' IRA assets could not have occurred without Defendants' participation in and execution of the purchase. That is, without Defendants' assistance with and participation in the purchase of Unregistered Securities, [Seller] would not have been able to sell the Unregistered Securities to Plaintiffs." (ECF No. 1, PageID 12, ¶ 49). Furthermore, the complaint alleges "that the seller, on behalf of [PENSCO], assisted Mr. Flanders in executing the documents necessary to transfer custodial responsibility for his IRA to Pensco," and that "[a]s a result, [PENSCO] established" an account in the name of Mr. Flanders. (*Id*. at 14, ¶61).

Further demonstrating PENSCO's participation, the Complaint alleges that the PENSCO collected money for the investments from the plaintiffs. Specifically, with respect to Mr. Flanders, the complaint alleges PENSCO, "on behalf of Mr. Flanders' Pensco IRA account, purchased an Unregistered Security" from the seller, and paid nearly $500,000 for it. (*Id*. at 15, ¶ 62). In other words, PENSCO both engaged in collecting money and communicating with the seller – factors that demonstrate participation for purposes of R.C. 1707.43.

of RTC, the plaintiffs in *Hardin* then purchased illegal securities that were then held by RTC. Although the plaintiffs' claim under Section 1704.43 was dismissed on summary judgment because it was ultimately barred by the statute of limitations, the *Hardin* court held that RTC's actions as the IRA custodian were sufficient to support a claim:

> As Plaintiffs point out in their motion for partial summary judgment, the term "participation" in O.R.C. §1707.43 is broad in scope given the "in any way" language. (Citation omitted) **RTC's role in purchasing the [securities] for the [Plaintiffs'] accounts is sufficient to form a possible basis for liability under O.R.C. §1707.43**. *See Federated Mgmt. Co. v. Coopers & Lybrand*, 137 Ohio App. 3d, 366, 392, 738 N.E.2d 842 (Ohio Ct. App. 2000)("participating in the sale or aiding the seller in any way is sufficient to form a basis for liability under R.C. 1707.43.")(emphasis added)

Id. at *30. RTC's role in *Hardin* is identical to PENSCO's role here. PENSCO purchased the securities for Mr. Hardin's account. PENSCO cannot escape the reality that its conduct, as spelled out in detail in the Complaint, forms the basis for a viable claim under Section 1707.43.[4]

B. <u>There is no exemption to R.C. 1707.43 for "normal commercial banking activities".</u>

Despite the numerous allegations detailing PENSCO's role in the sale of the illegal securities, PENSCO contends there is an exemption to the remedial statute for "financial institutions engage[ing] in 'normal commercial banking activities.'" (ECF No. 10, PageID 66). This position is belied by the plain wording of the statute.

The statute imposes liability for the sale of illegal securities on "[t]he person making such sale or contract for sale, and **<u>every person that has participated in or aided the seller in any way</u>** in making such sale or contract for sale…" O.R.C. § 1707.43 (emphasis added). The

[4] PENSCO cites Mr. Flanders' Custodial Agreement as a reason for why it claims it should not be held responsible for its role in the sale of the securities. (ECF No. 10, PageID 70). The Custodial Agreement has no relevance to this dispute. Mr. Flanders has not claimed PENSCO breached a contract. Instead, Mr. Flanders seeks to hold PENSCO responsible or its violation of Section 1707.43.

statute could not be clearer. If PENSCO aided Apostelos "in any way" in the sale of illegal securities or participated in the sale, it is liable. The breadth of the statute has been affirmed by Ohio courts without exception. The statute does not provide an exemption for actions characterized as "normal commercial banking activities."[5] This suggested exemption appears nowhere in O.R.C. § 1707.43. And to read this exemption into the statute now would be to narrow its scope and thereby reduce the protection given by the Ohio Legislature to the investing public. In short, PENSCO's attempt to limit the "in any way" language to cases where defendants do not perform "ordinary banking functions" ignores the guidance of nearly every court that has considered the breadth of the statute. *See Federated Mgmt.*, 137 Ohio App.3d at 391-392 (finding for the plaintiffs); *see also Vasa Order v. Rosenthal Collins Grp., L.L.C.*, C.P. No. CV 11 753705, 2013 Ohio Misc. LEXIS 3, at *15 (Ohio Jan. 29, 2013) (finding for the plaintiffs); *Wells Fargo Bank v. Smith*, 12th Dist. Brown No. CA2012-04-006, 2013-Ohio-855, ¶ 27; *Hild v. Woodcrest Asso*, 59 Ohio Misc. 13, 28-29, 391 N.E.2d 1047 (C.P.1977) (finding for the plaintiff); *In re Columbus Skyline*, 74 Ohio St.3d at 498; *In re Nat'l Century Fin.*, 755 F.Supp.2d at 873-874.

Despite the unassailable language of the statute and authority requiring broad application of the Ohio securities laws, PENSCO points to four cases it contends are "directly on point" and support its claimed "normal commercial banking activities" exemption. (ECF No. 10, PageID 66, citing *Wells Fargo*, 2013-Ohio-855; *Boomershine v. Lifetime Capital, Inc.*, 2d Dist. Montgomery No. 22179, 2008-Ohio-14; *Federated Mgmt.*, 137 Ohio App. 3d at 391-92; *Hild*, 59 Ohio Misc. 13). Procedurally, each of these cases was decided on summary judgment rather than

[5] Assuming *arguendo* there is a judicially recognized exemption for "normal banking activities," whether PENSCO's actions would fall within such an exception is a factual matter. And at this early pleading stage there is no proof before the Court (other than PENSCO's self-serving supposition) that any conduct by PENSCO would fall within any such exemption. In other words, PENSCO's activities here are not necessarily "normal" simply because PENSCO claims they are.

Rule 12 motions. *Wells Fargo*, 2013-Ohio-855 at ¶1; *Boomershine*, 2008-Ohio-14 at ¶6; *Federated Mgmt.*, 137 Ohio App. 3d at 375; *Hild*, 59 Ohio Misc. at 32. Thus, the legal standard is completely different – notice pleading as opposed to evaluating evidence garnered through discovery. In addition to this procedural distinction, the *Wells Fargo*, *Boomershine*, *Federated Mgt.* and *Hild* cases are factually distinguishable and do not stand for the propositions advanced by PENSCO.

In *Wells Fargo*, the plaintiff was a victim of a Ponzi scheme operated by Diversified Lending Group ("DLG"). *Wells Fargo*, 2013-Ohio-855 at ¶ 2. American Benefits Concepts ("ABC"), a company that sold Medicare supplements and investments, offered the DLG investment to its clients. ABC did not know the DLG securities were fraudulent. Some of ABC's clients would obtain mortgages on their homes in order to purchase the DLG investments. ABC referred its customers to several mortgage banking firms, including AmeriFirst. AmeriFirst closed a mortgage for the plaintiff who subsequently used the mortgage proceeds to purchase the DLG investment. AmeriFirst played no role in the actual sale of the investment to the plaintiff and had no relationship with DLG. Instead, the plaintiff applied for a mortgage, AmeriFirst closed the mortgage and disbursed the proceeds directly to the plaintiff, and then the plaintiff used the proceeds however she chose, including purchasing the DLG investment. The *Wells Fargo* court understandably concluded AmeriFirst did not participate in or aid in the illegal sales of securities because the mortgage services provided by AmeriFirst were not in any way tied to the actual sale of the illegal securities. As alleged in the Complaint, the facts in *Wells Fargo* are not remotely close to what happened in this case.

Here, unlike AmeriFirst, PENSCO's participation was not distinct from or independent of the purchase of the securities. Instead, PENSCO was at the center of the actual sale and its

participation was integral and necessary to the transaction. By way of example only, PENSCO oversaw and orchestrated the sale, requiring certain documents to be prepared in order to consummate the sale. (ECF No. 1, PageID 12, ¶¶ 50-51). PENSCO required specific terms to be included on the securities sold. (*Id*., ¶ 51). After PENSCO's requirements were met and the transaction reviewed by PENSCO's experts, PENSCO paid Apostelos and, in return, received and took custody of the securities sold to Mr. Flanders. (*Id*. at 3, 14, ¶¶ 5,61).[6] Finally, PENSCO collected fees tied directly to the sale. (*Id*. at 10, ¶ 42). PENSCO's effort to contort the holding of *Wells Fargo* into a blanket exemption to liability under O.R.C. §1707.43 for alleged "normal commercial banking activities" disrespects the facts of that case, the reasoning of that court, and the plain text of the statute.

Next, PENSCO points to the *Boomershine* case to support its fictional exemption. (ECF No. 10, PageID 67). Again, assuming *arguendo* the existence of a "normal banking activities"

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[6] PENSCO sets up a straw man argument claiming the Complaint only alleges interaction between PENSCO and Apostelos at two points – through a power of attorney Mr. Flanders granted to Apostelos and that Apostelos assisted Flanders with completing required PENSCO paperwork. (ECF No. 10, PageID 70). Aside from this being a tacit admission that PENSCO and Apostelos did interact, PENSCO's argument is misplaced. PENSCO first argues that "Mr. Flanders cannot now claim such communications, which he requested and authorized, serve as the basis for liability against PENSCO for *aiding* the seller in the sale of Securities". (*Id*. at 71) (emphasis added). Once again PENSCO's argument ignores the plain language of 1707.43 and its broad interpretation.

PENSCO also argues that the assertion that Apostelos was "acting 'on behalf' of PENSCO" is a legal conclusion insufficient to overcome a Rule 12(b)(6) motion. (ECF No. 10, PageID 71) (citing *16630 Southfield Ltd. P'ship v. Flagstar Bank, F.S.B.*, 727 F. 3d 502, 504 (6th Cir. 2013)). Contrary to PENSCO's assertion, this factual allegation, along with the balance of factual allegations in the Complaint, meets the requirements of notice pleading. Furthermore, the *16630 Southfield* case illustrates the stark contrast between an improper legal conclusion and, as in this Complaint, a plausible theory of liability. In *16630 Southfield*, the plaintiff filed suit alleging that a lender refused to restructure a loan because of his Iraqi origin. *16630 Southfield*, 727 F. 3d at 503. The trial court dismissed pursuant to Rule 12(b)(6) citing the plaintiff's repeated use of "upon information and belief" conclusory allegations regarding the lenders discrimination that simply recited a legal standard. *Id*. at 506. Importantly though, the *16630 Southfield* court recognized that "if a plaintiffs claim is plausible, the availability of other explanations – even more likely explanations – does not bar the door to discovery". *Id.* at 505. Here, that PENSCO participated in the sale of the securities is plausible and discovery is warranted. Apostelos brought Flanders to PENSCO specifically. (ECF No. 1, PageID 10, ¶ 41). PENSCO provided criteria under which it would purchase and take possession of the securities. (*Id*. at 12-13, ¶¶ 51-52). Furthermore, Apostelos facilitated, on behalf of PENSCO, the documentation required for Flanders to use PENSCO. Taken as a whole, these allegations certainly provide a plausible claim for relief sufficient to overcome a Rule 12(b)(6) challenge.

exemption, the behavior in *Boomershine* is starkly different than PENSCO's. In *Boomershine*, the plaintiffs purchased the illegal securities in 1999. *Boomershine,* 2008-Ohio-14 at ¶ 4. AVS and US Bank, the defendants who were granted summary judgment, were not involved until 2002 - three years after the sale of securities. *Id*. It is not hard to comprehend why the *Boomershine* court found, on summary judgment, the bank could not have participated or aided in the sale of securities when the sale at issue occurred three years before the bank had any involvement of any kind with the alleged scheme.

In contracts, PENSCO's involvement here did not come years after the sale to Mr. Flanders. Instead, PENSCO's role was to actually facilitate the sale of the securities to Mr. Flanders as PENSCO not only participated and aided in the sale, but was a necessary party.

In further support of its argument for a nonexistent exemption, PENSCO next claims *Federated Mgmt*. "delineates the types of activities that go beyond 'normal banking activities'" thereby presumably identifying conduct subjecting a defendant to liability under Section1707.43 (ECF No. 10, PageID 67-68). *Federated Mgmt.* does not stand for any such proposition and the *Federated Mgmt.* court certainly did not recognize a "normal banking activity" exemption to the statute. Instead, in discussing all of the facts relevant to summary judgment, the *Federated Mgmt*. court merely observed the appellee "engaged in activities that went beyond normal commercial banking activities." *Federated Mgmt.*, 137 Ohio App. 3d at 393.

Finally, PENSCO cites *Hild v. Woodrest Assn.* claiming, for purposes of O.R.C. §1707.43, a bank merely becoming "the depository of funds does not amount to a personal participation or aid in the making of a sale." (ECF No. 10, PageID 68). PENSCO takes out of context this observation by the *Hild* court.

In observing "the willingness of a bank to become the depository of funds does not amount to a personal participation or aid in making of a sale", the *Hild* court cited *Sorenson v. MacElrod*, 286 F.2d 72 (5th Cir. 1960). *Hild*, 59 Ohio Misc. at 31. The issue in *Sorenson*, however, was that, under Florida Supreme Court precedent, to be found to have personally participated or aided in making an illegal security sale, the defendant must have engaged in "some activity in inducing the purchaser to invest." *Sorenson*, 286 F.2d at 74. So under Florida law, the activity of a bank merely agreeing to become a depository of funds was not inducement of a purchaser to invest and, therefore, could not rise to the level of participating or aiding in the sale of a security.

The requirement of inducement by a secondary actor is not the law in Ohio and the conclusion reached by the *Sorenson* court has been soundly rejected by Ohio courts, including this one. *See In re Nat'l Century Fin.*, 755 F.Supp.2d at 884-885 ("The statute does not require knowledge, intent, or any other mental state on the part of the secondary actor, nor does it require reliance, inducement, or proximate cause as between the secondary actor and purchaser); *Federated Mgmt.*, 137 Ohio App.3d at 391 ("R.C. 1707.43 does not require that a person induce a purchaser to invest in order to be held liable. Rather, the language is very broad, and participating in the sale or aiding the seller in any way is sufficient to form a basis for liability under R.C. 1707.43"). PENSCO's suggestion that the observation expressed by the *Hild* court is somehow controlling or even applicable to this case is wrong.

Finally, PENSCO tries to paint a doomsday scenario resulting if its conduct in overseeing and orchestrating the sale of illegal securities to Mr. Flanders is found to be prohibited by Section 1707.43. (ECF No. 10, PageID 69). PENSCO's scenario is not rooted in reality because the Ohio Legislature, in its quest to protect the investing public from schemes such as the one

operated by Apostelos and facilitated by PENSCO, determined that if any party participates or aids in any way the sale of an unregistered security and makes money, the party does so at its peril. The Ohio Legislature limited the scope of Section 1707.43 by adopting various exemptions to liability under the statute. *See, e.g.*, O.R.C. §1707.431. If the Ohio Legislature wanted to carve out an exemption for self-directed IRA custodians, it certainly could have. But it did not.

C. <u>There is no exemption to R.C. 1707.43 for "passive custodians".</u>

PENSCO's final argument for dismissal is the legislature never intended to confer liability on self-described "passive" custodians. (ECF No. 10, PageID 72). In support, PENSCO points to R.C. §1707.431, which provides specific exemptions to liability created by the Ohio Legislature. PENSCO's position here is also contrary to Ohio law.

As discussed above, because the Ohio's Securities Act is remedial, including Section 1707.43, it must be read broadly to extend coverage and any exemptions, such as those in Section 1707.431, must be read narrowly. *Passa*, 2007 U.S. Dist. LEXIS 78905 at *18-21, citing *Cobb*, 452 F.3d at 559. *See also Wukelic*, 544 F.2d at 288. Without citation to any authority, PENSCO asks this Court to simply ignore this law and instead expand the specifically enumerated exemptions to include a new carve out for what PENSCO characterizes as "passive" custodians. PENSCO seeks to justify its request for judicially expanding the statutory exemptions by claiming its conduct here is not as egregious or culpable as others whose conduct may be exempted. (ECF No. 10, PageID 73). PENSCO cites to the exemption of persons who introduce victims to unscrupulous securities issuers and claims, if PENSCO had introduced Apostelos to Mr. Flanders, it would be exempted from liability imposed by Section 1707.43. PENSCO is wrong in its analysis because the exemption it cites applies only if the person

seeking the protection of the exemption did not receive, directly or indirectly, a commission, fee, or other remuneration based on the sale of any securities. O.R.C. § 1707.431(B). PENSCO received fees tied directly to the sale of illegal securities to Mr. Flanders so in its hypothetical scenario where it introduced Mr. Flanders to Apostelos, PENSCO could not take advantage of the exemption in Section 1707.431 and would still be subject to liability under Section 1707.43.

PENSCO's quest for a judicially recognized exemption is a futile one. If the Ohio Legislature wanted to exempt PENSCO's conduct, it would have. It did not. And it is not just the Ohio Legislature that has not adopted the exemption PENSCO seeks. The Ohio Department of Commerce, Division of Securities is specifically authorized to exempt, by rule adopted by the division, persons from liability imposed by Section 1707.43. *See* O.R.C. § 1707.431(C). The Division of Securities, like the Ohio Legislature, has not exempted the likes of PENSCO from the protections afforded the investing public by the Ohio Securities Act. This Court must decline to do what the Ohio Legislature and Division of Securities could have done if they deemed appropriate.

IV. CONCLUSION

The allegations against PENSCO are clearly stated in the Complaint and provide a plausible theory for recovery. That is all that is required under Federal Rule 8. There is no "normal banking activities" exemption to the participation liability of Section 1707.43. The Complaint alleges a myriad of participation by PENSCO in the sale of unregistered securities in violation of the Ohio Securities Act. At this stage, that is all that is required. Accordingly, PENSCO's motion to dismiss must be overruled.

Respectfully submitted,

/s/ Toby K. Henderson

Toby K. Henderson, Trial Attorney (0071378)
Scott S. Davies (0077080)
SEBALY SHILLITO + DYER
A Legal Professional Association
1900 Kettering Tower
40 North Main Street
Dayton, OH 45423
937/222-2500
937/222-6554 (fax)
thenderson@ssdlaw.com
Attorneys for Plaintiff

CERTIFICATE OF SERVICE

I certify that a true copy of the foregoing document was filed and served electronically through the Court's ECF system on March 18, 2016, upon:

Caroline H. Gentry, Esq.
PORTER, WRIGHT, MORRIS & ARTHUR LLP
One South Main Street, Suite 1600
Dayton, OH 45402
cgentry@porterwright.com
Counsel for Defendant
PENSCO Trust Company

Frances Floriano Goins, Esq.
Liam J. Dunn, Esq.
ULMER & BERNE LLP
1100 Skylight Office Tower
1660 West Second Street
Cleveland, OH 44113
fgoins@ulmer.com
ldunn@ulmer.com
Co-Counsel for Defendant
The Kingdom Trust Company

Robin D. Miller, Esq.
ULMER & BERNE LLP
600 Vine Street, Suite 2800
Cincinnati, OH 45202
rmiller@ulmer.com
Co-Counsel for Defendant
The Kingdom Trust Company

/s/ Toby K. Henderson
Toby K. Henderson