DISTRICT COURT, DENVER COUNTY, COLORADO Court Address: 1437 BANNOCK STREET, RM 256, DENVER, CO, 80202	DATE FILED: May 14, 2020 9:58 AM CASE NUMBER: 2018CV33011
Plaintiff(s) GERALD ROME SECURITIES COM FOR THE ST OF et al. v. **Defendant(s)** GARY DRAGUL et al.	⚠ **COURT USE ONLY** ⚠ Case Number: 2018CV33011 Division: 424 Courtroom:

Order:Defendant Gary Dragul's Motion for Clarification of Order Appointing Receiver that Receiver Lacks Standing to Assert Claims of Investors/Creditors w/ attach

The motion/proposed order attached hereto: DENIED.

The motion is denied for the reasons stated in the response.

Issue Date: 5/14/2020

MARTIN FOSTER EGELHOFF
District Court Judge

DISTRICT COURT, DENVER COUNTY **STATE OF COLORADO** 1437 Bannock St. Denver, CO 80202 (720) 865-8612	
Plaintiff: David S. Cheval, Acting Securities Commissioner for the State of Colorado v. **Defendants**: Gary Dragul, GDA Real Estate Services, LLC, and GDA Real Estate Management, LLC	▲ COURT USE ONLY ▲
Attorneys for Defendant Gary J. Dragul Paul L. Vorndran, Atty. Reg. No. 22098 Christopher S. Mills, Atty. Reg. No. 42042 Jones & Keller, P.C. 1999 Broadway, Suite 3150 Denver, CO 80202 Phone: 303-573-1600 Email: pvorndran@joneskeller.com cmills@joneskeller.com	Case No. 2018CV33011 Courtroom: 424

DEFENDANT GARY DRAGUL'S MOTION FOR CLARIFICATION OF ORDER APPOINTING RECEIVER THAT RECEIVER LACKS STANDING TO ASSERT CLAIMS OF INVESTORS/CREDITORS

On January 21, 2020, Harvey Sender, who was appointed Receiver *for* Defendant Gary J. Dragul and two of his entities, filed a separate complaint ("Complaint") against Mr. Dragul and myriad other defendants (Case No. 2020CV30255, hereafter "2020 Action"). In the 2020 Action, the Receiver alleges a vast scheme, undertaken by Mr. Dragul, his prior attorney, and several investors, to defraud other investors (whom the Receiver never identifies). He purports to bring the claims on behalf of those unnamed investors to recover their damages from the alleged fraud. The Receiver lacks this power under the Colorado Constitution and applicable

case law. The Receiver's power is based upon the people and entities in receivership. He can control claims against those people and entities. He can also assert claims belonging to those people and entities against third parties. What he cannot do as a matter of law, however, is assert third parties' claims, including those of investors. He has no standing to do so. Thus, Mr. Dragul, through counsel Jones & Keller, P.C., moves for an order from this Court clarifying that the order appointing the Receiver in this action does not vest the Receiver with standing to assert claims of investors/creditors of the Receivership Estate. In support of this motion ("Motion"), Mr. Dragul states as follows:

Certification of Conferral

Pursuant to C.R.C.P. 121 § 1-15(8), counsel for Gary J. Dragul conferred with counsel for the Plaintiff Commissioner and counsel for the Receiver. The Commissioner stated that he will likely oppose, but wishes to first review this Motion to determine the grounds. The Receiver opposes this Motion.

BACKGROUND

On August 15, 2018, the Colorado Securities Commissioner filed a complaint for injunctive and other relief against Mr. Dragul, GDA Real Estate Services, LLC ("GDARES"), and GDA Real Estate Management, LLC ("GDAREM") (GDARES and GDAREM are collectively referred to as "GDA Entities"). The Commissioner immediately moved to appoint a receiver over the GDA Entities and Mr. Dragul personally. Harvey Sender was appointed Receiver on August 30, 2018. (*See* August 30, 2018 Receivership Order ("Receivership Order")).

On January 21, 2020, the Receiver filed the Complaint in the 2020 Action alleging claims for: (1) violations of the Colorado Securities Act, C.R.S. §§ 11-51-501 and 11-51-604(3); (2) negligence; (3) negligent misrepresentation; (4) civil theft, C.R.S. § 18-4-401; (5) COCCA violations, C.R.S. § 18-17-101, *et seq.*; (6) aiding and abetting COCCA violations; (7) breach of fiduciary duty; (8) aiding and abetting breach of fiduciary duty; (9) negligence; (10) breach of fiduciary duty; (11) fraudulent transfer, C.R.S. § 38-8-105(1)(a); (12) constructive fraud; (13) unjust enrichment; and (14) turnover.[1] (*See* Compl., attached as Ex. 1.) In the Complaint, the Receiver expressly acknowledges that most of the claims are investors' claims. The rest are entirely based on alleged wrongful acts causing harm to investors. The Receiver relies on the Receivership Order to authorize him to assert investors' claims. However, as a matter of law, the Receiver lacks standing to assert investors' claims, and the Receivership Order cannot confer such standing upon him.

Mr. Dragul and several other defendants in the 2020 Action filed motions to dismiss arguing, in part, that the Receiver lacks standing to assert investors' claims. However, two of the defendants in that action, Marlin Hershey and Performance Holdings, Inc. (collectively, "Hershey Defendants"), moved to stay their deadline to respond to that Complaint. They also filed a motion to intervene in this action, seeking to assert a claim for declaratory relief that the Receivership Order does not vest the Receiver with standing to assert creditors' claims. However, the Court may resolve this issue more efficiently by clarifying the Receivership Order. In so doing, the Court need not decide the broader issues of intervention and a separate claim for

[1] The sixth, eighth, ninth, and tenth claims are not asserted against Mr. Dragul, but against other defendants.

declaratory relief. Hence, Mr. Dragul files this Motion respectfully requesting that the Court clarify that the Receivership Order, consistent with well-established standing law, does not imbue the Receiver with standing to assert third parties' claims.

ARGUMENT

I. The Receiver Lacks Standing to Assert Investors' Claims

A receiver's role is to gather and preserve the assets of the entities or people in receivership for later distribution to creditors of those same entities or people in receivership. Consistent with that role, a receiver is often authorized to prosecute claims *held by* the entities or people in receivership against third parties. The resulting recovery is then added to the asset pool for later distribution to the creditors. The receiver's power to assert those claims stems from the receiver's control over those entities or people in receivership.

As a matter of law, however, a receiver lacks authority to assert claims held by entities or people who are not in the receivership. Here, that means the Receiver may not assert claims of investors who have claims against, and are therefore creditors of, the Receivership Estate.

The Receiver asserts he has standing to prosecute claims one through six, eight, and nine on behalf of Special Purpose Entities and/or investors—"all of whom are creditors of the Receivership Estate." (Ex. 1, Compl. ¶¶ 167, 177, 182, 193, 200, 214, 236. 241.) The Receiver alleges breaches of duties owed to investor-creditors in claims seven and ten (*id*. ¶¶ 229, 230, 249), again indicating the Receiver is asserting claims on behalf of investors. He alleges fraudulent transfer of commissions from investors to defendants in claim eleven (*id*. ¶ 257), and constructive fraud for failing to provide equivalent value for the commissions taken from investor money in claim twelve (*id*. ¶¶ 262-263). He alleges the defendants received benefits at

the expense of creditors in the thirteenth claim for unjust enrichment. (*Id*. ¶ 268.)[2] Indeed, all of the alleged wrongful acts there—failure to disclose, collecting commissions out of investor funds, etc.—could only have injured the investors. But as a legal matter, the Receiver lacks standing to assert investors' claims.

"The proper inquiry on standing is whether the plaintiff has suffered injury in fact to a legally protected interest as contemplated by statutory or constitutional provisions." *Wimberly v. Ettenberg*, 570 P.2d 535, 539 (Colo. 1977). "Resolution of a standing issue presents two considerations: whether the complaining party has alleged an actual injury from the challenged action; and whether the injury is to a legally protected or cognizable interest as contemplated by statutory or constitutional provisions." *Sender v. Kidder Peabody & Co., Inc.*, 952 P.2d 779, 781 (Colo. App 1997).

> The 'injury-in-fact' requirement is dictated by the need to assure that an actual controversy exists so that the matter is a proper one for judicial resolution, for consistent with the separation of powers doctrine embodied in Article III of the Colorado Constitution, '[c]ourts cannot, under the pretense of an actual case, assume powers vested in either the executive or legislative branches of government.'

Conrad v. City and Cty of Denver, 656 P.2d 662, 668 (Colo. 1982).

The Receiver in this matter has at least once before argued that he may assert creditors' claims. The court rejected that argument. In *Sender v. Kidder Peabody*, 952 P.2d at 780, the Receiver served as a bankruptcy trustee and filed a complaint alleging aiding and abetting breach of fiduciary duty, negligence, and breach of fiduciary duty against third-party financial

[2] There and elsewhere, the Receiver also asserts the Receivership Estate has been injured. But all the factual averments in the Complaint allege wrongdoing only through 2018, before the Receivership Estate existed.

institutions. The trial court granted summary judgment in favor of the defendants based on *in pari delicto* and lack of standing. The Receiver appealed, and the Colorado Court of Appeals affirmed, holding among other things that "[a] bankruptcy trustee cannot assert the claims of creditors or third parties but stands in the shoes of the debtor and may properly assert claims belonging to the debtor." *Id*. at 781 (citing *Sender v. Simon*, 84 F.3d 1299 (10th Cir. 1996); *Miller v. Accelerated Bureau of Collections, Inc.*, 932 P.2d 824 (Colo. App. 1996)). Myriad other courts have similarly held that receivers and trustees lack standing to assert creditor claims. *See, e.g., In re M & L Business Machine Co., Inc.*, 160 B.R. 850, 851 (D. Colo. 1993) (holding that a bankruptcy trustee, analogous to the Receiver here, lacked standing to assert creditors' claims against third parties; collecting cases); *Javitch v. First Union Sec., Inc.*, 315 F.3d 619, 627 (6th Cir. 2003) ("[A]lthough the stated objective of a receivership may be to preserve the estate for the benefit of creditors, that does not equate to a grant of authority to pursue claims belonging to the creditors."); *Scholes v. Lehmann*, 56 F.3d 750, 753 (7th Cir. 1995) (An "equity receiver may sue only to redress injuries to the entity in receivership.").

"[G]enerally, a receiver stands in the shoes of the entity in receivership and may assert no greater rights than the entity whose property the receiver was appointed to preserve." *Good Shepherd Health Facilities of Colorado, Inc. v. Department of Health*, 789 P.2d 423, 425 (Colo. App. 1989) (citing *Seckler v. J.I. Case Co.*, 348 P.2d 368 (Colo. 1960)); *see also Kelley v. College of St. Benedict*, 901 F. Supp. 2d 1123, 1128 (D. Minn. 2012) ("[The defendant] is correct that an equity receiver may sue only on behalf of the entity (or person) in receivership, not third parties. This is because a receiver 'stands in the shoes' of the receivership entity.").

The office of a receiver is akin to that of a trustee. *See, e.g.*, *Rossi v. Colorado Pulp & Paper Co.*, 299 P. 19, 33 (Colo. 1931) ("[T]he office of receiver is in the nature of that of a trustee, and those who have lawful claims against the receivership estate are *cestuis que trustent*."); *see also Kelley*, 901 F. Supp. 2d at 1128 ("A federal equity receiver is akin to a bankruptcy trustee.") Just as a bankruptcy trustee may not assert creditors' claims, *Sender*, 952 P.2d at 779 (citing cases), a receiver may not assert creditors' claims, *Kelley*, 901 F. Supp. 2d at 1128. Federal courts have noted that the role of an equity receiver is "to maximize the receivership estates' assets for the benefit of creditors, . . . but contrary to [the receiver's] assertion it does *not* give him standing to sue on their behalf." *Kelley*, 901 F. Supp. 2d at 1128 (emphasis in original). Further, the Colorado Court of Appeals has stated:

> If a cause of action alleges only indirect harm to a creditor (that is, an injury that derives from harm to the debtor), and the debtor could have raised a claim for its direct injury under the applicable law, then the cause of action belongs to the estate. Conversely, if the cause of action does not explicitly or implicitly allege harm to the debtor, then the cause of action could not have been asserted by the debtor as of the commencement of the case, and thus is not property of the estate.

First Horizon Merchant Services, Inc. v. Wellspring Capital Management, LLC, 166 P.3d 166, 180 (Colo. App. 2007).

II. The Receivership Order Cannot Create Standing Where None Exists

In support of his claimed authority to assert creditors' claims, the Receiver cites Paragraph 13(s) of the Receivership Order. (Ex. 1, Compl. ¶¶ 167, 177, 182, 193, 200, 214, 236, 241.) Paragraph 13(s) provides that the Receiver has the authority "[t]o prosecute claims and causes of action held by Creditors of Dragul, GDARES and GDAREM, and any subsidiary entities for the benefit of Creditors, in order to assure the equal treatment of all similarly situated Creditors." Read literally, Paragraph 13(s) appears to authorize the Receiver to assert certain

creditors' claims. But the Receivership Order may not grant the Receiver standing he lacks as a matter of law. "[T]he appointment of a receiver is inherently limited by the jurisdictional constraints of Article III and all other curbs on federal court jurisdiction." *Scholes v. Schroeder*, 744 F. Supp. 1419, 1421 (N.D. Ill. 1990). "Granting a receiver authority to bring claims held by others would violate those limitations, as 'the ability to confer substantive legal rights that may create standing [under] Article III is vested in Congress and not the judiciary.'" *Kelley*, 901 F. Supp. 2d at 1129 (quoting *Scholes*, 744 F. Supp. at 1421 n.6)). The *Kelley* court explained:

> [I]f 'a district court could confer individual creditors' standing on a receiver simply by ordering it so, such an exception would completely swallow the general rule that receivers may only sue on behalf of the entity they are appointed to represent, not on behalf of creditors . . . directly.' Simply put, 'in attempting to recover on behalf of [creditors], the Receiver purports to assert rights of third parties . . . [T]he Receiver lacks standing to do so.'

Id. (quoting *Liberte Capital Grp. v. Capwill*, 248 Fed. Appx. 650, 657-58 (6th Cir. 2007); *In re Wiand*, Civ. No. 8:05-1856, 2007 WL 963165, at *2 (M.D. Fla. Mar. 27, 2007)); *see also Scholes v. Schroeder*, 744 F. Supp. at 1421 ("To the extent that the orders [appointing receiver]. . . purport to authorize suit on behalf of the investors, those orders are at odds with the fundamental command of Article III."); *see also id.* at 1420-23 (additional discussion re same); *Fleming v. Lind–Waldock & Co.*, 922 F.2d 20, 24-25 (1st Cir. 1990) (although the district court empowered the receiver "to prevent irreparable loss, damage and injury to commodity customers and clients," the receiver lacked standing to sue for claims belonging to investors); *B.E.L.T., Inc. v. Lacrad Intern. Corp.*, No. 01 C 4296, 2002 WL 1905389, at *1–2 (N.D. Ill. Aug. 19, 2002) (receiver had no standing to sue for, inter alia, receipt of funds fraudulently obtained, fraud, and unjust enrichment even though he was appointed "on behalf of all the creditors," because those were claims of the creditors, not of the debtor); *Marwil v. Farah*, No. 1:03–CV–0482–DFH,

2003 WL 23095657, at *7 (S.D. Ind. Dec.11, 2003) (receiver lacked standing to sue on behalf of investors notwithstanding the language of the receivership court order that purported to enable him to do so because the court lacked the authority to transfer property—including causes of action—from the investors to the receiver).

Like federal courts, the Colorado Supreme Court has expressly held that state courts may not confer standing where Colorado's legislative and executive branches have not otherwise conferred it:

> Although state courts are not subject to the provisions of Article III of the United States Constitution, similar considerations operate to require state courts to apply the standing doctrine. In Colorado, Article III of the Colorado Constitution prohibits any branch of government from assuming the powers of another branch. Courts cannot, under the pretense of an actual case, assume powers vested in either the executive or the legislative branches of government.

Wimberly v. Ettenberg, 570 P.2d 535, 538 (Colo. 1977) (holding that a county court's formulation of bail bond procedures could not confer standing on plaintiff bail bondsmen where they otherwise failed to establish injury to a legal right protected by any statutory or constitutional provision); see also *id*. at 539 (noting that "[a]part from this constitutional underpinning, judicial self-restraint, based upon considerations of judicial efficiency and economy, also supports the [standing] doctrine."). The Receivership Order cannot create jurisdiction over investors' claims where none exists.[3]

[3] Nor does it matter that the Receivership Order was stipulated. In Colorado, the issue of standing is jurisdictional. *Ainscough v. Owens*, 90 P.3d 851, 855 (Colo. 2004). Because standing is jurisdictional, it is not subject to waiver. *See, e.g.*, *Native American Arts, Inc. v. The Waldron Corp.*, 253 F. Supp. 2d 1041, 1048 (N.D. Ill. 2003). Both Federal Rule of Civil Procedure 12(h)(3) and its Colorado counterpart provide that, "[w]henever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court *shall* dismiss the action." (emphasis added). Thus, "[e]ven where the parties agree that a plaintiff has Constitutional standing, courts must satisfy themselves that the jurisdictional

Asserting creditors' claims also conflicts with other parts of the Receivership Order. Paragraph 16 provides that "[a]ny parties holding claims against Dragul, GDARES and GDAREM or the Receivership Estate shall not be entitled to participate as creditors in the distribution of recoveries from the Receiver's administration of the Receivership Estate and collection and liquidation of the assets thereof, unless such parties agree not to file or prosecute independent claims such parties may have . . . against Dragul, GDARES and GDAREM[.]" Under the literal language of Paragraph 16, the Receiver is waiving those investors' rights to participate in the distribution of recoveries from the Receivership when he asserts those creditors' claims. And since the money the Receiver seeks to recover through the Complaint will go to the Receivership Estate first and not directly to those investors, that means the investors will have no recovery. The Receiver lacks authority to so waive those investors' claims and recovery. And doing so is contrary to the Receiver's purpose to collect Receivership Property in order to pay creditors. (Receivership Order ¶ 22(c), (e), (f).) This untenable result is easily avoided by clarifying that the Receiver lacks authority to assert creditors' claims.

Since the claims of creditors are not claims held by the person or entities in receivership, the Receiver lacks standing to assert their claims as a matter of law. The Court should clarify that Paragraph 13(s) does not authorize the Receiver to assert creditors' claims. Rather, Paragraph 13(s) should be clarified to authorize the Receiver "[t]o prosecute claims and causes of action held by ~~Creditors of~~ Dragul, GDARES and GDAREM, ~~and any subsidiary entities,~~ for the benefit of Creditors, in order to assure the equal treatment of all similarly situated Creditors."

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requirement is met." *Id.* (citing *Rhodes v. Johnson*, 153 F.3d 785, 787 (7th Cir. 1998); Fed. R. Civ. P. 12(h)(3)).

CONCLUSION

The Receiver here seeks to exercise power he does not have. His power derives from the people or entities in receivership. He lacks standing to assert claims of creditors, who are not in receivership. The Court should clarify that the Receivership Order does not vest the Receiver with standing he lacks as a matter of law.

Respectfully submitted this 21st day of April, 2020.

JONES & KELLER, P.C.

/s/ Christopher S. Mills

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ATTORNEYS FOR DEFENDANT GARY DRAGUL

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **DEFENDANT GARY DRAGUL'S MOTION FOR CLARIFICATION OF ORDER APPOINTING RECEIVER THAT RECEIVER LACKS STANDING TO ASSERT CLAIMS OF INVESTORS/CREDITORS** was filed and served via the ICCES e-file system on this 21st day of April 2020 to all counsel of record for the parties to the action, including the following:

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