IN THE CIRCUIT COURT FOR MONTGOMERY COUNTY, MARYLAND

JEFFREY J. CONNAUGHTON, et al,	)	
Plaintiff	)	
	)	
v.	)	**Case No. 461362 V**
	)	
GARY W. DAY, et al	)	
Defendant	)	

MEMORANDUM OPINION AND ORDER

This matter was before the court on October 31, 2019 in regard to Plaintiffs' Amended Motion for Class Certification, which was filed herein on September 25, 2019 at DE 77. Plaintiffs and some of the Defendants appeared through counsel. Other Defendants did not appear, presumably because they had not been served with initial process, the Motion, or both. The Court heard from those who appeared. For the reasons outlined below, the Court will DENY the motion.

Procedural History

Plaintiffs initiated this case on January 7, 2019 with the filing of their original complaint naming four defendants ("the original Defendants"). These were Gary Day, John May, Acrebay Capital Management LLC ("Acrebay"), and Credit Portfolio Lending II LLC. In general, Plaintiffs described the case as a securities fraud class action in which the Defendants were principals of a "feeder fund" that procured investors for what turned out to be a Ponzi scheme run by non-parties Kevin Merrill, Jay Ledford, and Cameron Jezierski, working through non-party entities that they owned. Collectively, Plaintiffs referred to Merrill, Ledford, and Jezierski, and their entities as the "MLJ Group."

Specifically, Plaintiffs alleged that the original Defendants solicited, and sold, investments in securities offered by the MLJ Group. These securities were in the form of promissory notes, called "Revolving Promissory Notes," such that investors would lend money to entities ("MLJ Borrowers") within the MLJ Group. The loan proceeds were to be used by the MLJ Borrowers to purchase debt portfolios on an ongoing basis, and the loans would be collateralized by the debt portfolios. For this purpose, original Defendant Day formed Credit Portfolio Lending, II, LLC ("CPL2"), which would serve as "Administrative Agent." This arrangement was memorialized in a "Business Loan and Security Agreement," ("CPL2 BLSA") that recited " . . . the proceeds of [the investors'] loans would be used to acquire credit card debt portfolios." *See* Complaint at ¶ 27. In later versions of their Complaint, Plaintiffs would allege that the CPL2 BLSA required CPL2 to act as an "Indenture Trustee" and then a Fiduciary, with all of the attendant duties.

Plaintiffs allege that the original Defendants negligently failed to conduct due diligence regarding the securities they were selling, affirmatively misrepresented their technical expertise, and concealed their level of involvement in what Plaintiffs came to learn was an "opaque venture managed by others." Complaint at ¶ 1. The Complaint contained five counts. Counts I and II alleged violations of the Maryland Securities Act; Count III alleged Fraud; Count IV alleged Negligent Misrepresentation; and Count V alleged Breach of Fiduciary Duty.

On June 14, 2019, the parties appeared for a Scheduling Hearing. The Court changed the Track from 5 to 6.[1] Time standards for Track 6 were discussed, and a trial date of April 20, 2020 was established within the times standards for that Track, among other dates. Plaintiffs

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[1] *See* Civil Differentiated Case Management Plan, Circuit Court for Montgomery County, Maryland, (April, 2017), https://montgomerycountymd.gov/cct/departments/dcm.html

represented that they intended to move for certification of their putative class, and on June 18, 2019, at DE 54, they did so. On July 25, 2019, the Court extended the deadline for response to the pending class certification motion to September 13, 2019. This deadline would be extended again to October 11, 2019.

Over the summer, Plaintiffs and the original Defendants exchanged and responded to some written discovery requests. In addition, on September 5, 2019, the original Defendants deposed Scott Oser, one of the named Plaintiffs.

On Sept 17, 2019, Plaintiffs filed a Second Amended Complaint, in which they added 14 additional defendants ("the new Defendants") and new claims for Negligence, Professional Malpractice, Aiding and Abetting Breach of Fiduciary Duty, Conversion, violations of the Maryland Uniform Fraudulent Conveyances Act, and Constructive Trust. Beyond what had already been alleged, Plaintiffs identified two additional entities, Bethesda Capital Investors, LLC ("BCI") and Exponential Growth Partners, LLC ("EGP"), through which Defendant Day allegedly funneled money to non-party Kevin Merrill. See Plaintiffs' Second Amended Complaint at ¶¶ 46 and 47. Plaintiffs also named Scott Museles, Esquire, and his law firm, Shulman, Rogers, Gandal, Pordy & Ecker, P.A., and alleged that after Mr. Museles formed CPL2 and prepared the CPL2 BLSA, he and his firm served as "indenture counsel" but disregarded their professional responsibilities, including their obligation to file UCC financing statements to secure the promissory notes.

Dividing the group of those who "invested" through BCI, EGP, and CPL2 into Plaintiffs on the one hand, and "Ponzi Winners" on the other, Plaintiffs alleged that funds provided by the Plaintiffs (largely those "investing" through CPL2) were used to pay off the Ponzi Winners (largely those "investing" through BCI and EGP). Even after the United States Securities and

Exchange Commission announced that it had obtained injunctive relief against the MLJ Group on September 18, 2018, the original Defendants diverted funds to creditors they wished to pay at the expense of other CPL2 Noteholders. From the Ponzi Winners, Plaintiffs sought claw back remedies. A Third Amended Complaint followed on September 25, 2019, in which Plaintiffs removed a claim for conversion, and added a claim for civil conspiracy and a prayer for punitive damages, among other changes.[2]

On September 25, 2019, Plaintiffs filed the instant Motion. The certificate of service indicates that Mr. Shealy and Mr. Etelson were served with it as "Counsel for Defendants." The Court infers that this means the original Defendants, as Ms. Shealy and Mr. Etelson did not enter their appearance on behalf of Bethesda Capital Investors, LLC (a new Defendant) until October 21, 2019 at DE 90. If any of the new Defendants were served with the instant Motion, Plaintiffs have not filed an Amended Certificate of Service indicating as much.

On October 30, 2019, the original Defendants filed their Opposition Memorandum. The new Defendants have not filed a written opposition. Nor have the new Defendants participated in the discovery that occurred over the summer.

On October 31, 2019, Plaintiffs' attorneys represented that all but one of the new Defendants had been served, although they did not know precisely when. Affidavits of Service had not been filed.

Proposed Class

[2] Counts I and II alleged violations of Maryland's Securities Act; Count III alleged Fraud; Count IV alleged Negligent Misrepresentation; Count V alleged Civil Conspiracy; Count VI alleged Negligence; Count VII alleged Breach of Fiduciary Duty; Count VIII alleged Professional Malpractice; Count IX alleged Aiding and Abetting Breach of Fiduciary Duty; Count X alleged Violation of Maryland's Uniform Fraudulent Conveyance Act; and Count XI alleged Constructive Trust.

With their motion, Plaintiffs seek certification of a class of "[a]ll persons who lent money to the MLJ Borrowers by means of a 'Revolving Promissory Note' for which CPL2 served as 'Administrative Agent' and who were damaged thereby. Excluded from the Class are the following 'Excluded Persons:' (1) 'Ponzi Winners,' which is defined to mean persons who made a net profit on their participation in the Ponzi Scheme, and (2) 'Affiliated Persons' who are affiliated with one or more Defendants or the MLJ Group." Footnote 5 of the instant Motion further defines "Affiliated Persons."

Looking to Maryland Rules 2-231(b) and (c),[3] Plaintiffs contend that this proposed class satisfies all of the requirements of Rule 2-231(b) and Rule 2-231(c)(3), and should be certified. Plaintiffs have not shown as much, however.

Maryland Rule 2-231(b) Threshold Requirements

(1) the class is so numerous that joinder of all members is impracticable – "Numerosity"

Plaintiffs claim that the putative class numbers somewhere between 45-50 members, an estimate backed up by the affidavit of Plaintiffs' attorney only. The original Defendants say that the putative class numbers 35 individuals only. *See* Affidavit of Defendant Gary Day, attached as Exhibit 1 to the original Defendants' Opposition Memorandum.

[3] Plaintiffs cite Maryland Rules 2-231(a) and 2-231(b)(3). After Plaintiffs initiated this suit, but before they moved for class certification, Maryland's Court of Appeals amended Rule 2-231. The amendment added a new section (a) eliminating the possibility of defendant classes, renumbered the remaining sections, and made other technical amendments. Accordingly, the Court will treat Plaintiffs' citation to Rule 2-231(a) and 2-231(b)(3) as pertaining to Rules 2-231(b) and 2-231(c)(3) respectively.

Based on detail provided by Mr. Day, as well as his admitted familiarity with those who lent funds to the MLJ Borrowers, the Court finds that his assessment of the size of the putative class is more reliable than Plaintiffs', and the Court accepts it.

With regard to whether joinder of 35 is or is not impracticable, Plaintiffs provide no real non-conclusory reason why joinder of 35 would be impracticable. Here, based on Mr. Day's affidavit, the named Plaintiffs know who the other putative plaintiffs are. And the deadline for joinder of parties has not passed. It is January 27, 2020. Nor have Plaintiffs proven that class litigation is the only practicable alternative for putative class members with smaller claims. In fact, one other "investor," Mr. Katski, has already initiated a separate case in this court.[4] Under these circumstances, Plaintiffs have not met their burden of showing that joinder is impracticable.

(2) there are questions of law or fact common to the class – "Commonality"

At Paragraph 182 of their Third Amended Complaint, Plaintiffs list 15 common questions of law or fact that they say justify class certification. These are, in essence, whether the statement that the proceeds of the CPL2 Notes[5] were being used to acquire consumer debt portfolios was untrue; whether the Defendants Day, May, Acrebay, and CPL2 ("the Acrebay Defendants") sold the CPL2 Notes by means of this untrue statement; whether the Acrebay Defendants could have discovered the untruth of this statement through the exercise of reasonable care; whether the Acrebay Defendants are liable to Plaintiffs for having made the

[4] *See Robert T. Katski v. Acrebay Investment Management, Inc., et al.*, Case No. 467964V, Circuit Court for Montgomery County, Maryland.

[5] The "CPL2 Notes" refer to the promissory notes over which CPL2 acted as Administrative Agent. The "CPL2 Noteholders" are those who held the CPL2 Notes.

untrue statement; what duties (if any) CPL2 and the Shulman Defendants owed to Plaintiffs; whether these duties were breached; and whether Plaintiffs have standing to sue the Shulman Defendants; to what remedies, if any, are the Ponzi Winners subject; and whether Plaintiffs have been damaged.

To avoid certification, the original Defendants lean largely on their anticipated defenses, but in doing so, reveal why there is some commonality here.[6] Thus, one broad set of questions regards the extent to which the original Defendants can be held liable for the statement that the proceeds of the CPL2 Notes were being used to acquire consumer debt portfolios. No Defendant contends that this statement was true. Instead, Defendants Day, May, and Acrebay deny personal liability because they were not parties to the CPL2 BLSA, the contract in which the statement appeared. Defendant CPL2 was a party to the CPL2 BLSA but denies liability because the CPL2 BLSA puts responsibility for the truth of the statement on the MLJ Borrowers. Because all of the putative class members were parties to the CPL2 BLSA, determining the effectiveness of these defenses is likely to drive the outcome herein for all putative class members.

Another broad set of questions surrounds what duties, if any, CPL2 owed to the putative class members as holders of the promissory notes, and whether Maryland has causes of action for breaches of these duties. The original Defendants deny that an "indenture trustee" relationship exists such that CPL2 would have any duties to the putative class members, adding that the CPL2 BLSA expressly disclaims any such duties. Moreover, because all loaned funds of the

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[6] *See Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 350 (2011)(" . . . [w]hat matters . . . is not the raising of common 'questions'—even in droves—but rather, the capacity of a class-wide proceeding to generate common answers apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers." (omitting citations).

putative class members were to be transmitted to the MLJ Borrowers, and were, the putative class members have no creditor relationship with the original Defendants. Any funds remaining with CPL2, Day or May after the September 18, 2018 default belonged either to CPL2, Day, or May, or were governed not by the CPL2 BLSA but rather by other agreements between individual class members and CPL2. As to Breach of Fiduciary Duty, or Aiding and Abetting same, the original Defendants argue that no such causes exist in Maryland.

Most, but not all, of these questions can likely be decided as a matter of law. For example, the CPL2 BLSA's plain language will tell us whether CPL2 effectively disclaimed any duties it might have had to all putative class members as Indenture Trustee. [7] And the availability of Breach of Fiduciary Duty and Aiding and Abetting to the putative class will turn on appellate decisions. But sorting out which funds remained with CPL2 after September 18, 2018, such that CPL2 could be held liable for failing to return funds it held, likely requires tracing, and the answer will vary by class member. But the need for individual tracing does not undermine the commonality evident in the above legal questions.

Another broad set of questions surrounds whether the putative class members have standing to sue the Shulman Defendants. Because the Shulman Defendants have not been heard on this motion, the Court will not address the commonality (or not) of these questions at this time.

Another broad set of questions surrounds whether those identified as "Ponzi Winners" profited from the Ponzi scheme, and whether their profits should be subject to claw back remedies. Although all of the Plaintiffs allege one mechanism for recovery, namely that these Defendants got paid with funds Plaintiffs supplied pursuant to the CPL2 BLSA, 20 of the 35

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[7] To date, no one has claimed that the CPL2 BLSA is ambiguous in this regard.

putative class members did not start "investing" with CPL2 until after October, 2016, well after BCI (and likely EGP) received their last payments. Among the 15 putative class members who "invested" before October, 2016, only five did so with BCI before it accepted its last payment on May 24, 2016. The other ten did not "invest" with BCI before it accepted its last payment. Thus, for the 20 class members that got in after October, 2016, the necessary tracing may mean that their claims fail. For the 15 class members that got in before BCI and EGP received their last payments, tracing may be more difficult but could mean that their claims succeed. Given these differences, and as to this set of questions, the Court cannot conclude there is sufficient commonality among all putative class members.

The final set of broad questions surrounds whether putative class members have sustained damages and the proper measure of same. Presumably, each putative class member lost a different amount. That damages have to be calculated individually does not mean that certification on liability is inappropriate.

Based on the above, the Court is satisfied that Plaintiffs have identified seven common questions of law and fact. These are:

(1) whether the statement that the proceeds of the CPL2 Notes were being used to acquire consumer debt portfolios was untrue;

(2) whether the Acrebay Defendants sold notes to the CPL2 Noteholders by means of the foregoing untrue statement;

(3) whether the Acrebay Defendants can meet their burden of proof to show that they cold not have discovered the foregoing untruth through the exercise of reasonable care;

(4) whether the Acrebay Defendants were sufficiently negligent in making that untrue statement to be liable under the common law of negligent misrepresentation;

(5) whether the Acrebay Defendants were sufficiently reckless in making that untrue statement to be liable under the common law of fraud;

(6) whether CPL2, acting as indenture trustee, breached its duties of care to CPL2 Noteholders; and

(7) precisely when did CPL2 become a fiduciary (and not just an identure trustee with a duty of ordinary care) to the CPL2 Noteholders;

(3) the claims of the representative parties are typical of the claims of the class – "Typicality"

The named Plaintiffs assert that their claims are typical of those in the putative class because all damages arise out of the same misrepresentation that caused all to invest in the promissory notes coupled with the same breaches of duty by the Defendants. According to the original Defendants, though, Plaintiffs overlook issues peculiar to the named Plaintiffs, issues that render their claims atypical of the entire class.

With regard to reliance, the original Defendants say that Plaintiff Oser has admitted that he did not rely on the representations in the CP2 BLSA before deciding to get into the transaction at issue. In fact, Plaintiff Oser had no contact with Defendant Day prior to deciding to get into the transaction, and instead, relied on the advice of his accountant, Mr. Heiserman. Plaintiff Katz has admitted that he had no phone calls with the Defendants and little or no substantive email contact with them. Like Plaintiff Oser, Plaintiffs Katz and Connaughton were introduced to the transaction by Mr. Heiserman. Apparently, Mr. Heiserman made this

introduction to Plaintiffs Oser, Connaughton, Katz, and a handful of other (but not all) putative class members.

Beyond class members brought in by Mr. Heiserman, those who did have contact with the original Defendants did not receive scripted information from them prior to deciding to get in. Instead, these other putative class members apparently received unscripted information through one-on-one personal meetings, phone calls, or emails. The information varied based on nature of the relationship with the individual investor and the questions he or she posed. With each variation in what these other putative class members learned from the original Defendants, and how much each relied on it, each putative class member's claim looks less and less like that of the named Plaintiffs.

Ultimately, because they were introduced to the transaction by Mr. Heiserman, Plaintiffs' Oser, Connaughton, and Katz's complaint may not be with the original Defendants at all. And if Plaintiffs Connaughton and Katz relied on something the original Defendants represented, that representation may differ from the information that prompted others to get in. Against this background, the court cannot conclude that the claims of Plaintiffs Oser, Connaughton, and Katz are typical of those of the class.

(4) the representative parties will fairly and adequately protect the interests of the class – "Adequacy"

Plaintiffs assert that because they are adequate representatives because they have impressive educations and experience, have cooperated with their attorneys to produce written discovery responses, have retained qualified attorneys, and have no conflicts with putative class members. Not all of this is true.

Notwithstanding Plaintiffs' assertions, because Mr. Oser, (and perhaps Mr. Katz, and Mr. Connaughton) did not rely on the CPL2 BLSA in deciding to "invest," but rather on the representations of Mr. Heiserman, the named Plaintiffs cannot adequately represent those who got in based on the representations of the Acrebay Defendants. Nor can the named Plaintiffs adequately represent the interests of Mr. Heiserman, who is himself a target of potential claims and a putative class member. Under these circumstances, the Court is not persuaded that these named Plaintiffs can adequately represent the putative class.

In sum, Plaintiffs meet the second requirement of Rule 2-231(b) as to some Defendants, but do not meet the remaining threshold requirements of this Rule.

Maryland Rule 2-231(c)(3)

Plaintiffs seek certification based on Rule 2-231(c)(3). This Rule provides that

> [u]nless justice requires otherwise, an action may be maintained as a class action if the prerequisites of section (b) are satisfied, and in addition:
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> * * *
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> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution of separate actions, (B) the extent and nature of any litigation concerning the controversy already commenced by members of the class, (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum, (D) the difficulties likely to be encountered in the management of a class action.

Even if Plaintiffs had met the threshold requirements of Rule 2-231(b), their claim for certification under Rule 2-231(c)(3) fails.

With regard to predominance, Plaintiffs argue that because investors would not knowingly get into a Ponzi scheme, telling them that their funds were being used to acquire credit card debt portfolios is the fact that predominates over all others. Thus, the real focus of

the case is this misrepresentation and the duties Defendants owed to all putative class members. Because Maryland is the only forum where all Defendants could be sued and because of the relatively small amounts some class members invested, a class action is superior to other available methods of adjudication. Again, Plaintiffs are not entirely correct.

Because reliance can be unique to each putative class member, common law fraud claims are not typically susceptible to class action treatment.[8] *See Philip Morris v. Angeletti*, 358 Md. 689, 751 (2000). Thus, while class members may receive one misrepresentation, such that there is some commonality, the extent to which each individual member actually relied on the misrepresentation can vary from member to member and ultimately predominate. Here, for example, at least one Plaintiff, Mr. Oser, did not rely on the CPL2 BLSA at all, but relied instead on what Mr. Heiserman told him. Mr. Heiserman also introduced Plaintiffs Connaughton and Katz, and a "handful of others" to the transaction; perhaps they, too, relied Mr. Heiserman's representations. Indeed, Plaintiff Katz had little or no substantial contact with the Defendants at all. With regard to the representations that did come from Defendants (as opposed to Mr. Heiserman), other class members received unscripted information one-on-one, another arrangement that invites the possibility of varying representations and varying levels of reliance among class members. Ultimately, because the answers to these questions will vary by class member, and then drive outcomes that vary by class member, these individual questions predominate.

With regard to the superiority (or not) of class action as a means of adjudicating this dispute, even if Plaintiffs could make a strong showing of predominance, the current schedule for

[8] Plaintiffs assert that their Maryland Securities Act claims do not require a showing of reliance. Because the Court concludes that individual questions predominate in Plaintiffs' common law fraud claims, the Court need not reach this issue now.

this case makes it hard to conclude that class action is a fair and efficient means of adjudication for the new Defendants. Plaintiffs added these defendants approximately 60 days after having first filed for class certification and did not serve them with the original motion or the instant amended motion. As a consequence, the new Defendants have not had a chance to conduct discovery in regard to class certification and have not been heard on it.

Today's decisions (or non-decisions) do not eliminate this unfairness. For the Shulman Defendants, the Court did not address the commonality (if any) of the broad set of questions that appears chiefly directed at them. For the those identified as Ponzi Winners, the Court did address the commonality of the broad questions that appears to involve them, but concluded that there was insufficient commonality, even without having heard from these Defendants. But these decisions (or non-decisions) do not contour perfectly to who has (or has not) been served and who is (or is not) named in a particular count. For example, while common questions (1) through (3) above do not appear to involve the Shulman Defendants, the Shulman Defendants are named in Count II as having materially aided three of the four "Acrebay Defendants." Accordingly, the Shulman Defendants may well want to be heard on whether these questions warrant class certification.

Trial is scheduled for April 20, 2020, a date to which the named Plaintiffs and the original Defendants agreed when they appeared for scheduling on June 14, 2019, and that is within case time standards. How the Court could afford the new Defendants a meaningful opportunity to be heard on the instant motion without jeopardizing this trial date is unclear. But even if the Court were to postpone the existing trial date to or beyond the June 30, 2020 case time deadline, such a postponement would not cure the shortcomings in Plaintiffs' attempt to meet Rule 2-231(b)'s threshold requirements. Specifically, more time would not resolve the

apparent conflict between the named Plaintiffs and Mr. Heiserman or eliminate what appear to be varying representations and degrees of reliance among the putative class members. Nor would more time bridge the gap between those putative class members who "invested" before October, 2016 and those who did so afterward.

Under these circumstances, the Court cannot conclude that common questions predominate over individual ones or that certification of Plaintiffs' proposed class is the superior method of proceeding.

ORDER

For the foregoing reasons, it is this ~~8th~~ 12th day of November, 2019, by the Circuit Court for Montgomery County, Maryland, hereby

ORDERED, that Plaintiff's Amended Motion for Class Certification (DE 77) be and is hereby DENIED.

akc

Anne K. Albright
Judge
Circuit Court for Montgomery County, Maryland