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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

In Re:

LLS AMERICA, LLC,

Debtor,

BRUCE P. KRIEGMAN, solely in his
capacity as court-appointed Chapter 11
Trustee for LLS America, LLC,

Plaintiff,

v.

HORST ROMANI, et al.,

Defendants.

NO: CV-13-18-RMP

Bankr. Case No. 09-06194-PCW11

Adv. Proc. No. 11-80287-PCW11

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This consolidated action was tried before the Court from June 2 through
June 3, 2014. Plaintiff, Bruce P. Kriegman, the court-appointed Chapter 11
Trustee for LLS America, LLC (“Trustee”), was represented by Thomas Cochran
of Witherspoon Kelley. Defendants Horst and Claudine Romani appeared pro se.

1 H & C Investments, Ltd. and the Estate of Rene and Armande Baudez were
2 represented by Dillon Jackson of Foster Pepper. Claudine Romani, the executor
3 of the Estate of Rene and Armande Baudez, previously terminated Foster Pepper
4 as counsel for the Estate. ECF Nos. 44, 45. However, at times during trial, Ms.
5 Romani allowed Mr. Jackson to participate on the Estate's behalf.

6 The Court heard the testimony of the parties' witnesses and, having
7 reviewed the admitted exhibits and being fully informed, makes the following
8 findings of fact and conclusions of law:

9 **PREVIOUS RULINGS**

10 **1. Ponzi Scheme and Insolvency**

11 On July 1, 2013, the Bankruptcy Court issued its Report and
12 Recommendation Re Plaintiff's Motion for Partial Summary Judgment on
13 Common Issues ("Report and Recommendation"), recommending that the District
14 Court grant the Trustee's Amended Motion for Partial Summary Judgment on two
15 "Common Issues": (1) Debtor operated a Ponzi scheme; and (2) Debtor was
16 insolvent at the time of its transfers to the defendants. On August 19, 2013, this
17 Court adopted the Bankruptcy Court's Report and Recommendation and entered
18 an order granting the Trustee's Amended Motion for Partial Summary Judgment
19 on the Common Issues ("Order Adopting Report and Recommendation"). *See*
20 2:11-cv-00357-RMP, ECF No. 92. Therefore, this Court has determined that

1 Debtor operated a Ponzi scheme and was insolvent at the time of each of the
2 transfers to Defendants.

3 All of the findings and conclusions set forth in the Report and
4 Recommendation and the Order Adopting Report and Recommendation are
5 incorporated by this reference and are the law of this case.

6 **2. Omnibus Hearing for the Testimony of Charles Hall**

7 On January 31, 2014, the Court granted Plaintiff's Motion for Omnibus
8 Hearing. ECF No. 26. Pursuant to that Order, the court-appointed examiner,
9 Charles Hall, testified at an Omnibus Hearing in open court commencing on
10 February 25, 2014. His testimony consists of written direct examination
11 testimony that was filed on or about February 17, 2014, and the oral testimony
12 that he gave at the Omnibus Hearing. Mr. Hall was cross examined by several
13 defense attorneys, including those from Foster Pepper, and by some pro se
14 defendants. Mr. Hall's testimony at the Omnibus Hearing became part of the
15 record in this adversary action.

16 **FINDINGS OF FACT**

17 1. Debtor is the Little Loan Shoppe group of companies, which
18 originally was formed in 1997. PO-1 at 11.

1 2. Debtor operated a Ponzi scheme, whereby investors' loans were
2 sometimes used to pay other investors' promised returns on investments. PO-1 at
3 16.

4 3. Over the course of its existence, Debtor acquired approximately
5 \$135.4 million from investments made by individual lenders and documented by
6 means of promissory notes offering interest returns in the range of 40%-60% per
7 annum. PO-1 at 7 n.2, 15.

8 4. Defendants made loans to Debtor.

9 5. Defendants all received interest and principal payments from Debtor.
10 Dozens of the payments that Defendants received were written on checks showing
11 Debtor's Spokane address. P-14; P-34.

12 6. Defendants are "net winners."

13 7. Debtor was never profitable at any time during its existence and thus,
14 at no time did it generate sufficient profits to pay the amounts due the lenders.
15 PO-1 at 16.

16 8. Debtor accumulated payday loan bad debts of approximately \$29
17 million, which were written off in 2009. PO-1 at 41.

18 9. Debtor gave lenders, including Defendants, post-dated checks to
19 cover interest payments, but some checks had insufficient funds to cover payment
20 of the checks. PO-1 at 24-25; P-16 at 17-18; P-37 at 1-2.

1 10. Debtor voided approximately 29,000 of the post-dated checks that it
2 had issued to lenders, including Defendants. PO-1 at 26; P-16 at 17-18; P-37 at 1-
3 2.

4 11. Some of the promissory notes that Defendants received from Debtor
5 were executed in Washington State. *See* P-25 at 2; P-26 at 2; P-27 at 4; P-31 at
6 12-17.

7 12. The Baudezes received promissory notes that were rolled into or
8 renewed into other promissory notes. P-30 at 3; P-31 at 10, 12, 13, 16.

9 13. There is no evidence that Defendants ever received any account
10 statements or financial statements from Debtor.

11 14. All of the transfers that the Trustee seeks to avoid were made within
12 the period of September 1997 to July 21, 2009. *See* P-10 at 28; P-30 at 17.

13 15. Each of the Defendants filed proofs of claim in Debtor's Bankruptcy
14 case. P-21; P-22; P-23; P-24; P-25; P-26; P-31.

15 16. Indicia and characteristics of the Ponzi scheme present in this case
16 include:

17 a. Proceeds received from new investors masked as profits from
18 running a payday loan business; PO-1 at 16, 22;

19 b. Promise of a high rate of return on the funds of between 40%
20 to as much as 60%; PO-1 at 19;

1 c. Debtor paid commissions to third parties who solicited new
2 lenders, typically 10% annually of the amount received from the new
3 lender; PO-1 at 20, 21;

4 d. Debtor solicited funds as loans evidenced by a promissory
5 note but demonstrated a pattern of “rolling over” the promissory notes
6 when due onto new notes instead of paying off the obligation; PO-1 at 26;

7 e. Debtor, throughout its history, made false and misleading
8 statements to current and potential lenders; PO-1 at 53-54;

9 f. Debtor was insolvent from its inception to the filing of its
10 bankruptcy; PO-1 at 67.

11 17. The court-appointed examiner, Charles B. Hall, by way of education,
12 experience, and vocation, is qualified to analyze and review the legitimacy of an
13 enterprise’s operation to detect a fraud based on Ponzi scheme operations.

14 18. Mr. Hall, during the Omnibus Hearing, both in writing and in oral
15 testimony described Mr. Hall’s understanding of Horst Romani’s role in Debtor’s
16 Ponzi scheme. *See* PO-1 at 58-62.

17 19. Mr. Hall’s expert opinion is credible.

18 20. Mr. Curtis Frye’s testimony, which pertained to Debtor’s record
19 keeping and the accounting of investment, payments, and consulting
20 fees/commissions to the Defendants, is credible.

1 21. Specific findings of fact for each Defendant are as follows:

2 **a. Horst and Claudine Romani**

3 The Romanis began investing in Debtor in 2000 and started receiving
4 interest payments. P-12 at 1; P-10 at 7. Like other investors, the Romanis
5 received promissory notes from Debtor offering interest returns of 40%-60% per
6 annum. *See, e.g.*, P-21 at 2; P-23 at 3-4. Mr. Romani also received finder's fees
7 or commissions for soliciting new investors for Debtor. *See* PO-14 at 8, 14.
8 There is no evidence that the Romanis significantly researched Debtor before
9 investing, relying instead on the experience of their friend who had invested in
10 Debtor and on information that they received from Doris Nelson, Debtor's
11 proprietor. P-28 at 12-13. The Romanis testified that, although the interest rates
12 on the promissory notes were high, they compared the rates to high interest rates
13 for credit cards. The Romanis also testified that the promissory notes' interest
14 rates seemed legitimate in light of the interest rates charged in Debtor's allegedly
15 lucrative business of payday lending. At some point, the Romanis visited
16 Debtor's business in Spokane, Washington, coming away impressed. P-28 at 13.

17 The Court finds credible the Romanis' testimony that, at least in the
18 beginning of their relationship with Debtor, they believed that they were among a
19 small group of contributors to Debtor and that Ms. Nelson continued to share her
20 success with them out of friendship. The Court finds that, initially, the Romanis

1 invested and received payments from Debtor under an objective standard of good
2 faith. The Romanis' testimony regarding their early relationship with Debtor is
3 credible and supports the Court's finding that they were unaware at that time of
4 many of the red flags that would have alerted a reasonable person to the fraudulent
5 nature of Debtor's scheme.

6 As their involvement with Debtor progressed, however, the Court finds that
7 the Romanis became aware of facts that would have revealed the fraud to a
8 reasonably prudent person.

9 The evidence shows that Mr. Romani learned of significant signs of
10 Debtor's fraud through his efforts to find new investors. Contrary to Mr.
11 Romani's testimony that he merely put potential investors in contact with Debtor,
12 his emails show that he more actively solicited new investments. On December
13 15, 2007, for example, Mr. Romani explained to a potential investor the terms of
14 investing in Debtor and revealed how much money he and his friends had
15 invested. PO-14 at 20. Mr. Romani also reminded Debtor of the importance of
16 his role in raising additional funds. *See* PO-14 at 22 (“ . . . I guess [Ms. Nelson]
17 would like to thank me for the \$ 1,000,000 bucks I got her over the last couple of
18 weeks”); P-20 at 16 (“ . . . I have provided for you in total over 3 Million dollars,
19 of which I feel very much personally responsible for. Believe me, I am always the
20 first one to get the phone calls if you default or are late making payments.”).

1 Further, on April 1, 2008, Mr. Romani informed Debtor that future investors
2 would not receive 60% interest; “40% is plenty[.] I rather take the difference as
3 finders [sic] fee.” PO-14 at 23. Mr. Romani suggested that Debtor should “[j]ust
4 tell them the Law has changed and its [sic] not possible to pay 60%.” PO-14 at
5 23. These emails show that Mr. Romani was aware of Debtor’s suspicious
6 business practices and that he even directed Debtor to deceive an investor so that
7 he could receive a larger commission.

8 The regularly missed payments and other issues that investors raised should
9 have alerted Mr. Romani and caused him at least to investigate Debtor more
10 thoroughly. Instead, when the British Columbia Securities Commission was
11 investigating Debtor in October 2008, Mr. Romani told Ms. Nelson that he
12 preferred to communicate using encrypted emails rather than through phone calls,
13 which he suspected that the Commission could record. PO-14 at 32. Mr. Romani
14 recounted in a later email to Ms. Nelson that during the Commission’s
15 investigation, “we [had] to lie for you through our teeth to keep you out of
16 trouble.” P-20 at 17. At some point while the Romanis were receiving payments
17 from Debtor, Mr. Romani’s need to “lie through our teeth” provided sufficient
18 notice to Mr. Romani that would have warned a reasonable person that Debtor’s
19 business was fraudulent.

20

1 The Court finds that the Romanis have established that they acted within the
2 objective standard of good faith during the first years of their relationship with
3 Debtor. The record shows that as of April 1, 2008, however, Mr. Romani was
4 aware of facts that should have alerted him to Debtor's fraud. On that date, Mr.
5 Romani instructed Debtor to misinform an investor that due to an apparently
6 fictitious and arbitrarily chosen change in the law, the investor would receive a
7 lower interest rate. PO-14 at 23. Mr. Romani should have been aware of Debtor's
8 fraud by that date because he understood that Debtor would deceive an investor
9 for his benefit.

10 **b. Rene and Armande Baudez**

11 Rene and Armande Baudez, Ms. Romani's parents, first began investing in
12 Debtor in October 2000. P-33 at 1. Much like the Romanis, the Baudezes
13 received promissory notes from Debtor with high interest rates of 40%-60%. *See,*
14 *e.g.,* P-36 at 19, 25. Interest payments to the Baudezes were delayed at times, and
15 on one occasion Debtor sent the Baudezes a significant overpayment, which the
16 Baudezes sought to return. PO-14 at 17.

17 Unlike the Romanis, the Baudezes did not speak English, and there is no
18 evidence that they ever communicated directly with Debtor. Ms. Romani testified
19 that the Baudezes were not aware that a commission or finder's fee was paid on
20 their investment. Other than the fact that Mr. Baudez signed the checks from

1 Debtor, the Romanis' testimony and Mr. Romani's emails indicate that Mr.
2 Romani managed the Baudezes' investments with Debtor. *See* PO-14 at 16-17.

3 The Baudezes relied on the experience of their son-in-law, apparently due
4 in part to their lack of understanding of the English language. Other than the high
5 interest rates and occasional payment irregularities, the evidence shows that the
6 Baudezes were not aware of most of the signs of Debtor's fraud. The Baudezes
7 have met their burden of showing that they acted under the objective standard of
8 good faith.

9 22. The following summarizes the evidence of investments made by the
10 Romanis and the payments that they received:

11	Total Payments:	\$779,647.32
12	Total Investments:	\$350,697.50
13	MIMO:	\$428,949.82

14 23. At trial, Plaintiff conceded that two payments to the Baudezes that
15 are reflected in its dashboard summary are not supported by adequate evidence.
16 *See* P-33 at 6. The payments are for \$2,833.33 and \$19,875.00. P-33 at 6. The
17 Court subtracted these payments from its findings. The following summarizes the
18 evidence of investments made by the Baudezes and the payments that they
19 received:

20	Total Payments:	\$820,744.71
	Total Investments:	\$285,000.00
	MIMO:	\$535,744.71

1 promissory notes state that the notes will be governed by the laws of British
2 Columbia, Canada, many of the notes were also notarized in the State of
3 Washington, where Debtor had relocated its business. *See, e.g.*, P-31 at 12, 13,
4 14, 15, 16, 17. Moreover, Ms. Romani testified that Mr. Baudez endorsed the
5 checks from Debtor, dozens of which are labeled with Debtor's Spokane address,
6 P-34 at 100-359. For these reasons as well as those discussed in a related
7 adversary proceeding, *see* 2:11-cv-00362-RMP, ECF No. 148, the Court
8 concludes that it has statutory authority over this action.

9 5. At least one unsecured creditor existed who triggered the strong arm
10 power of 11 U.S.C. § 544(b)(1) because the creditor did not and should not
11 reasonably have discovered the fraudulent nature of Debtor's Ponzi scheme
12 transfers within one year before the bankruptcy petition was filed. *See* 2:11-cv-
13 00362-RMP, ECF No. 197.

14 6. Washington State law governing fraudulent transfers applies.

15 7. Under the statutes relating to fraudulent transfers, 11 U.S.C. § 548
16 and RCW 19.40, *et seq.*, payments received from Debtor are recoverable from
17 each Defendant by the Trustee, subject to the defense of good faith pursuant to 11
18 U.S.C. § 548(c) and RCW 19.40.081(a).

19 8. Transfers made in furtherance of a Ponzi scheme constitute actual
20 fraud under the Bankruptcy Code and Washington's version of the Uniform

1 Fraudulent Transfer Act (UFTA). *See* Bankr. Adv. Doc. 11-80299, ECF No. 378
2 at 21-25. “Where causes of action are brought under UFTA against Ponzi scheme
3 investors, the general rule is that to the extent innocent investors have received
4 payments in excess of the amounts of principal that they originally invested, those
5 payments are avoidable as fraudulent transfers” *Donell v. Kowell*, 533 F.3d
6 762, 770 (9th Cir. 2008).

7 9. A transferee of a fraudulent transfer may keep funds that it took for
8 reasonably equivalent value and in good faith. *See* 11 U.S.C. § 548(c); RCW
9 19.40.081(a). As recipients of transfers that constitute actual fraud, the burden of
10 proof in establishing the affirmative defense of good faith is on Defendants. *In re*
11 *Agric. Research and Tech. Grp., Inc.*, 916 F.2d 528, 535 (9th Cir. 1990); 5
12 COLLIER ON BANKRUPTCY ¶ 548.09[2][c] at 548-98.2 (16th ed. 2011).

13 10. Although “good faith” is not defined precisely in case law, at least one
14 court has noted that the absence of good faith is shown by a transferee who knows
15 that a debtor is operating a Ponzi scheme. *See In re Agric. Research*, 916 F.2d at
16 535 (citing *In re Indep. Clearing House*, 77 B.R. 843, 861 (D. Utah 1987)). The
17 Ninth Circuit has quoted favorably an explanation in an early case that a
18 transferee’s “knowledge or actual notice of circumstances sufficient to put him, as
19 a prudent man, upon inquiry as to whether his brother intended to delay or defraud
20

1 his creditors . . . should be deemed to have notice . . . as would invalidate the sale
2 as to him.” *Id.* at 535 (quoting *Shauer v. Alerton*, 151 U.S. 607, 621 (1894)).

3 11. Thus, courts measure good faith by an objective standard, looking to
4 what a transferee “‘knew or should have known’ in questions of good faith, rather
5 than examining what the transferee actually knew from a subjective standpoint.”
6 *Id.* at 535-36.

7 12. Under the Bankruptcy Code, Washington’s UFTA, as well as relevant
8 case law, the Court does not contemplate a recipient’s intent when deciding
9 whether to avoid fraudulent transfers. 5 COLLIER ON BANKRUPTCY ¶ 548.04[2] at
10 548-63; *Thompson v. Hanson*, 168 Wn.2d 738, 749 (2010). Accordingly, a
11 transfer that constitutes actual fraud is avoided in its entirety unless the transferee
12 establishes that a reasonable person in the transferee’s position would not and
13 should not have known of the fraud, not simply whether he or she *actually* acted in
14 good faith.

15 13. Transfers made by Debtor in furtherance of its Ponzi scheme are
16 transfers made with actual intent to hinder, delay and/or defraud creditors under
17 both state law, RCW Ch. 19.40, and federal law, 11 U.S.C. § 548(a)(1).

18 14. Defendants assert that they are entitled to retain the amount of
19 principal that they invested because they acted in good faith.
20

1 15. The Trustee is entitled to pre-judgment interest at the applicable
2 federal rate from July 21, 2009, when the bankruptcy case commenced.

3 16. Defendants **Horst and Claudine Romani** met their burden of
4 establishing that they accepted transfers from Debtor for value and in good faith
5 only up to April 1, 2008. The Romanis are entitled to retain **\$350,697.50**, the
6 amount of their investment in Debtor, from the sum of the transfers that they
7 received from Debtor prior to April 1, 2008.

8 17. Pursuant to 11 U.S.C. § 548(a), 544, 550 and 551 and RCW
9 19.40.041(1) and 19.40.071, the Trustee is entitled to and is granted a judgment for
10 the benefit of the Liquidating Trust of Debtor against **Horst and Claudine**
11 **Romani** in the amount of **\$428,949.82**, plus pre-judgment interest from July 21,
12 2009, at the applicable federal judgment rate and post-judgment interest at the
13 federal judgment rate from the date of judgment until the date that the judgment is
14 paid in full, *see* 28 U.S.C. § 1961.

15 18. Defendants **Rene and Armande Baudez** met their burden of
16 establishing that they accepted transfers from Debtor for value and in good faith.
17 The Estate of the Baudezes is entitled to retain **\$285,000.00**, the amount of their
18 investment in Debtor, from the sum of the transfers that they received from
19 Debtor.

