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UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

JAMES H. DONELL,	)	Case No. CV 12-04084 DDP (JEMx)
	)	
Plaintiff,	)	<b>ORDER DENYING DEFENDANT'S MOTION</b>
	)	<b>TO DISMISS COMPLAINT</b>
v.	)	
	)	
NIXON PEABODY LLP,	)	[Docket No. 9]
	)	
Defendant.	)	
	)	

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Presently before the court is Defendant Nixon Peabody LLP's Motion to Dismiss Complaint ("Motion"). Having reviewed the parties' moving papers and heard oral argument, the court denies the Motion, and adopts the following Order.

**I. BACKGROUND**

**A. SEC Action and Receivership Order**

This action is related to a January 2010 lawsuit that the Securities and Exchange Commission ("SEC") filed against John Farahi ("Farahi"), his corporation NewPoint Financial Services ("NewPoint"), and various other defendants, which is still pending before this court. The SEC accuses Farahi, NewPoint, and the other

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1 defendants of defrauding investors, in violation of various federal  
2 securities laws.

3 Pursuant to a joint stipulation by the parties in that action,  
4 the court issued a February 2010 Order ("Receivership Order")  
5 appointing current Plaintiff James H. Donell ("Receiver") as  
6 permanent receiver of NewPoint and various related entities. The  
7 Order grants the Receiver "full power over," among other things,  
8 all "choses in action . . . belonging to" NewPoint. (Receivership  
9 Order at 1.) The Order also authorizes the Receiver "to employ  
10 attorneys, accountants and others to investigate, and where  
11 appropriate, to institute, pursue, and prosecute all claims and  
12 causes of action of whatever kind and nature which may now or  
13 hereafter exist as a result of the activities of present or past  
14 employees or agents of NewPoint." (Id. at 2.)

15 **B. Allegations Against Nixon Peabody**

16 On May 10, 2012, the Receiver filed the present action against  
17 Defendant Nixon Peabody LLP ("Nixon Peabody"), alleging that Nixon  
18 Peabody, after being retained by NewPoint, instead helped Farahi  
19 "to loot the assets of NewPoint, to cause NewPoint to violate the  
20 federal securities laws, and to attempt to conceal Farahi's  
21 embezzlement of funds and NewPoint's numerous violations of the  
22 federal securities laws." (Compl. ¶ 1.) Based on this alleged  
23 misconduct by Nixon Peabody, the Receiver brings state law claims  
24 on behalf of NewPoint for breach of fiduciary duty, professional  
25 negligence, and constructive fraud. According to the Receiver,  
26 these actions damaged Newpoint by: 1) enabling "Farahi to loot even  
27 more funds from NewPoint"; 2) causing "NewPoint to incur additional  
28 liabilities to investors"; 3) deepening "NewPoint's already obvious

1 insolvency"; and 4) causing "NewPoint to commit multiple violations  
2 of the federal securities laws." (Id. ¶ 64.)

3 Specifically, the Receiver alleges in his Complaint that  
4 attorney David Tamman ("Tamman") started providing legal services  
5 to NewPoint in 2003, while working at another law firm. In  
6 particular, Tamman had drafted a revised "Private Placement  
7 Memorandum" ("PPM") for NewPoint, claiming a "Reg. D" exemption  
8 under Rule 506. A Rule 506 exemption requires that an offering be  
9 sold to no more than 35 non-accredited investors, all of whom must  
10 be "sophisticated investors," as defined by the Rule. The revised  
11 PPM also expressly stated that investor funds would not be used to  
12 make investments in securities. Farahi, however, filed a "Form D"  
13 earlier in 2004, making clear that investor funds would be used for  
14 such securities investments. According to the Receiver, Tamman  
15 therefore already knew or should have known that Farahi was  
16 operating NewPoint in violation of its PPM as of 2004, by  
17 improperly investing in securities.<sup>1</sup> The Receiver further alleges  
18 that this knowledge can be imputed to Nixon Peabody, once Tamman  
19 joined the firm as a partner in February 2007. (Id. ¶¶ 9, 17-21.)

20 Shortly after joining the firm, Tamman began providing legal  
21 services to NewPoint on behalf of Nixon Peabody as well, pursuant  
22 to a written retainer agreement. Among other things, in March  
23 2007, Tamman asked an associate to determine whether NewPoint's  
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25 <sup>1</sup> The Receiver also cites to the First Superseding Indictment  
26 in a federal criminal action against Tamman and Farahi. The  
27 Indictment alleges that Tamman had revised the original PPM to  
28 mislead the Financial Industry Regularity Authority during its 2004  
investigation of NewPoint. Among other things, Tamman allegedly  
added the above-mentioned statement that investor funds would not  
be used to invest in securities. (Id. ¶ 22.)

1 sale of debentures complied with the Reg. D securities exemptions  
2 set forth in Rules 504, 505, and 506. According to the Receiver,  
3 however, Tamman knew or should have known that NewPoint could not  
4 qualify for any of these exemptions. As discussed, the revised PPM  
5 that Tamman had prepared at his prior law firm claimed an exemption  
6 under Rule 506, which precludes sales to unsophisticated investors.  
7 Tamman, however, received emails on behalf of NewPoint in March and  
8 July 2007, which appeared to divide its investors into both  
9 "sophisticated" and "not sophisticated" categories. The Receiver  
10 also alleges that Tamman knew or should have known that Farahi was  
11 soliciting investments for NewPoint through a Farsi language radio  
12 program, which precluded NewPoint from qualifying under any of the  
13 Reg. D exemptions. (Id. ¶¶ 9-21.)

14 In sum, the Receiver contends that by 2007, Nixon Peabody,  
15 through Tamman, knew or should have known that Farahi was  
16 improperly operating NewPoint by: 1) making offerings not exempt  
17 under Reg. D; and 2) investing in securities, in violation of its  
18 PPM. Thus, according to the Receiver, "if Nixon Peabody had done  
19 its job . . . , it would have cut short by two years Farahi's  
20 looting of NewPoint Funds, and it would have ended NewPoint's  
21 continued violations of federal securities laws." (Id. ¶ 23.)

22 The Receiver further alleges that Tamman and Nixon Peabody  
23 then continued to work with Farahi, drafting a new PPM and  
24 offering. According to the Receiver, by claiming the same Reg. D  
25 exemption when it still clearly did not apply, Nixon Peabody again  
26 violated its professional duties. The new PPM prepared by Nixon  
27 Peabody also allegedly provided descriptions of prior debenture  
28

1 offerings by NewPoint that were contradicted by information  
2 previously provided to Nixon Peabody by NewPoint. (Id. ¶¶ 24-33.)

3       Then, in 2008, Farahi allegedly lost more than \$30 million in  
4 personal trading, and covered some of those losses using NewPoint  
5 funds. According to the Receiver, Nixon Peabody continued  
6 assisting Farahi in other ventures, separate from and sometimes in  
7 competition with NewPoint, during this time, but billing NewPoint.  
8 Nixon Peabody also allegedly learned by late 2008 that Farahi had  
9 lost between \$7 and \$11 million of NewPoint funds. Nixon Peabody  
10 then concluded that NewPoint could use a new offering and the  
11 proceeds therefrom to cover the losses, so long as it made proper  
12 disclosures. Nixon Peabody therefore allegedly continued working  
13 on the new PPM and, at the request of Farahi, increased the amount  
14 of the offering to \$30 million. The new PPM also stated that  
15 NewPoint had "experienced significant losses in the last 60 days  
16 due in part to current negative market conditions." According to  
17 the Receiver, Tamman at least knew or should have known that these  
18 losses were inconsistent with the existing PPMs, and likely knew  
19 the real reason for the losses - Farahi's personal trading - but no  
20 one at Nixon Peabody did any due diligence in investigating the  
21 losses. Indeed, another Nixon Peabody partner allegedly expressed  
22 concerns at that time that Tamman had "done no diligence on the  
23 client." (Id. ¶¶ 34-44.)

24       Thus, the Receiver contends that by this point: Tamman  
25 "either knew nothing about his client or disclosed nothing to his  
26 fellow partners. Instead, he simply did the bidding of non-client  
27 Farahi. While he did so, . . . Farahi diverted between \$7 million  
28 and \$11 million in NewPoint funds to cover some of [his \$30 million

1 in personal] losses." Tamman, himself, also allegedly admits that  
2 he knew Farahi's personal investments had caused NewPoint's losses,  
3 as of March 2009. According to the Receiver, however, Tamman made  
4 no effort to then alert NewPoint's compliance officer of the  
5 apparent embezzlement. (Id. ¶¶ 44-45, 51.)

6 Finally, as things continued to derail, another Nixon Peabody  
7 partner allegedly advised Tamman during a March 2009 meeting that:  
8 given the losses "caused by previously undisclosed loans to Farahi,  
9 investors needed to be advised of their right to rescind."  
10 According to the Receiver, however, Nixon Peabody never took any  
11 such action to protect NewPoint. Shortly after, in April 2009,  
12 Nixon Peabody began assisting Farahi and NewPoint to respond to an  
13 SEC investigation. In doing so, Tamman and an associate allegedly  
14 prepared a fraudulent "unsecured revolving promissory note," back-  
15 dated to October 1, 2008, to conceal Farahi's embezzlement of funds  
16 from NewPoint. Similarly, in July 2009, Tamman allegedly provided  
17 what he claimed were final versions of various NewPoint PPMs, for  
18 production to the SEC. Among other alleged changes, Tamman edited  
19 NewPoint's original 2003 PPM by removing statements regarding Reg.  
20 D exemptions and that funds would not be invested in securities,  
21 and by adding language referring to outstanding loans and  
22 permitting additional loans to Farahi. Also in July 2009, Tamman  
23 allegedly instructed Nixon Peabody not to produce to the SEC a June  
24 2009 document, in which someone at Nixon Peabody had "asked an  
25 associate to research the basic issue of whether the [NewPoint]  
26 debentures constituted securities." (Id. ¶¶ 46-58, 24-25.)

27 Accordingly, the Receiver contends that, in this final stage,  
28 Tamman and Nixon Peabody were actively "promoting, protecting,

1 aiding and abetting the misappropriation of NewPoint funds by  
2 Farahi." (Id. ¶ 59; see also id. ("Nixon Peabody had evidence that  
3 a crime had been committed against its client by Farahi; it  
4 responded by fabricating evidence to conceal the crime.").)

## 5 **II. DISCUSSION**

6 In its Motion, Nixon Peabody makes a number of arguments for  
7 why the Receiver's Complaint must be dismissed. The court does not  
8 find any of these arguments persuasive.

### 9 **A. Receivership's Authority**

10 Nixon Peabody first argues that the Receiver lacks authority  
11 under the court's Receivership Order to bring the present action,  
12 at least without requesting specific permission from the court.  
13 The court disagrees. As discussed, the court's Receivership Order  
14 expressly authorizes the Receiver to step into the shoes of  
15 NewPoint and pursue all causes of action belonging to NewPoint.  
16 The court's Order does not require the Receiver to seek  
17 authorization from the court prior to bringing any such action.

### 18 **B. Constitutional Issues**

19 Nixon Peabody next argues that the Receiver's lawsuit  
20 constitutionally violates: 1) the Appointments Clause; 2) Article  
21 III and separation of powers principles; and 3) Supreme Court  
22 precedent restricting the use of courts' inherent equitable powers.  
23 The court does not find any of these arguments convincing.

24 In making the first two arguments, Nixon Peabody suggests that  
25 the Receiver is acting as a prosecutor for the SEC or the court.  
26 This is not the case. As discussed, the Receiver is stepping into  
27 the shoes of a private party - NewPoint - and pursuing claims  
28 against Nixon Peabody that this private party could have brought

1 itself. Thus, none of the precedent cited by Nixon Peabody is  
2 applicable.

3 As to the third argument, Nixon Peabody contends that the  
4 Receiver's state law tort claims go beyond traditional receiver  
5 actions for disgorgement or to "claw back" proceeds from fraudulent  
6 schemes. Nixon Peabody argues that allowing the Receiver to  
7 proceed with its claims would therefore exceed the court's inherent  
8 equitable powers. In support of this conclusion, however, Nixon  
9 Peabody cites only to the Supreme Court's decision in Grupo  
10 Mexicano v. Alliance Bond Fund, 527 U.S. 308 (1999). There, the  
11 Supreme Court held that a federal district court lacked the  
12 authority, in an action solely for money damages, to issue a  
13 preliminary injunction freezing a defendant's assets. See id. at  
14 310, 333. Contrary to Nixon Peabody's argument, Grupo Mexicano is  
15 not analogous to the situation here, where the Receiver has been  
16 appointed to step into the shoes of NewPoint, and is now pursuing  
17 legal claims against Nixon Peabody that NewPoint itself could have  
18 brought.

### 19 **C. Subject Matter Jurisdiction**

20 Nixon Peabody also argues that the court lacks subject matter  
21 jurisdiction over the Receiver's action. The court disagrees. As  
22 the Receiver explains in its Opposition, ancillary jurisdiction is  
23 appropriate here under a century of Supreme Court precedent  
24 establishing such jurisdiction over all actions "brought by a  
25 receiver in furtherance of its appointment where the district court  
26 had federal question jurisdiction over the original action in which  
27 it appointed the receiver." Robb Evans & Assocs., LLC v.  
28 Holibaugh, 609 F.3d 359, 362 (4th Cir. 2010) (citing Riehle v.



1 Margolies, 279 U.S. 218, 223 (1929); Pope v. Louisville, N.A. & C.  
2 Ry. Co., 173 U.S. 573, 577 (1899); and White v. Ewing, 159 U.S. 36,  
3 38-39 (1895)).

4 In arguing to the contrary, Nixon Peabody relies primarily on  
5 the Supreme Court's denial of ancillary jurisdiction in Peacock v.  
6 Thomas, 516 U.S. 349 (1996). However, as the Receiver explains,  
7 Peacock is wholly inapplicable because, among other things: 1) it  
8 "did not involve either a receivership or a claim brought by a  
9 receiver"; and 2) because the relevant prior action had already  
10 ended, "there was no pending federal action to which plaintiff's  
11 action could be deemed ancillary." (Opp'n at 12 (citing Peacock,  
12 516 U.S. at 359).) The Receiver's action here, of course, does  
13 involve a receivership and a case still pending in this court to  
14 which the instant action is ancillary. The court therefore finds  
15 that ancillary jurisdiction is appropriate and that there is  
16 subject matter jurisdiction over this action.

#### 17 **D. Standing**

18 Next, Nixon Peabody argues that the Receiver lacks standing to  
19 pursue this action because NewPoint is simply an "alter ego" of  
20 Farahi.<sup>2</sup> In support of this argument, Nixon Peabody cites to  
21 Second Circuit cases relying on that Circuit's decision in Shearson  
22 Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114 (2d Cir. 1991). Under  
23 the so-called Wagoner rule, as Nixon Peabody describes it, "a  
24 trustee or receiver who 'stands in the shoes' of an entity that was  
25 wholly owned and operated by the admitted mastermind and

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26  
27 <sup>2</sup> An inference from this argument is that Nixon Peabody knew  
28 or arguably should have known that Farahi was so obviously using  
NewPoint as his personal asset that Nixon Peabody had, at the very  
least, an obligation to withdraw as NewPoint's counsel.

1 perpetrator of a fraudulent scheme has no standing to sue third  
2 parties who allegedly failed to stop the scheme." (Reply at 10.)

3 As the Receiver explains, however, the Ninth Circuit has never  
4 adopted the Wagoner rule, and expressly declined to follow it in an  
5 unpublished decision in 2008. See CarrAmerica Realty Corp. v.  
6 Nvidia Corp., 302 Fed. App'x. 514, 517 (9th Cir. 2008). As the  
7 Ninth Circuit panel also noted, "the Wagoner rule has been much  
8 criticized" outside of the Second Circuit. See, e.g., In re Senior  
9 Cottages of Am., LLC, 482 F.3d 997, 1003-04 (8th Cir. 2007).

10 Accordingly, the court declines to adopt the Wagoner rule and  
11 dismiss the Receiver's action for lack of standing.

#### 12 **E. Causation**

13 Finally, Nixon Peabody contends that the Receiver has failed  
14 to adequately allege causation, "an essential element of each of  
15 the Receiver's purported tort claims." (Mot. at 19.) In short,  
16 Nixon Peabody argues that the only damages alleged by the Receiver  
17 are from Farahi's diversion of NewPoint funds to cover his personal  
18 investment losses in 2008. According to Nixon Peabody, the  
19 Receiver only alleges that Nixon Peabody learned of this diversion  
20 of funds - and then began preparing a new PPM and forging documents  
21 - afterwards. Thus, Nixon Peabody could not have had any role in  
22 causing this economic loss. The court disagrees.

23 First, as discussed, the Receiver expressly alleges that Nixon  
24 Peabody's unlawful conduct enabled "Farahi to loot even more funds  
25 from NewPoint," caused "NewPoint to incur additional liabilities to  
26 investors," and deepened "NewPoint's already obvious insolvency."  
27 In other words, according to the Receiver's Complaint, NewPoint's  
28 economic damages were not limited to a one-time diversion of funds

1 by Farahi. Rather, NewPoint continued to suffer economic harm as a  
2 result of Nixon Peabody's alleged failure to then stop and report  
3 the ongoing embezzlement - and eventual cover-up efforts - in  
4 violation of the firm's professional duties.

5 Contrary to Nixon Peabody's contentions, the Receiver also  
6 expressly alleges that the firm knew or should have known facts  
7 that would have prevented or limited Farahi's alleged looting of  
8 NewPoint in the first place, and provides sufficient facts to  
9 support this allegation. As discussed in detail above, Nixon  
10 Peabody partner David Tamman allegedly knew or had reason to know  
11 that Farahi was operating NewPoint in violation of its own PPMs and  
12 federal securities law, by investing in securities and claiming  
13 inapplicable exemptions. According to the Receiver, Nixon Peabody  
14 therefore enabled - and played a causal role - in Farahi's later  
15 embezzlement, by failing to recognize and stop his already unlawful  
16 operations beforehand. The Receiver summarizes these allegations,  
17 and the inferences therefrom:

18 The complaint contains 25 pages of factual allegations  
19 based on identified sources that demonstrate that Nixon  
20 attorneys actively assisted Farahi to embezzle funds from  
21 NewPoint and then helped him try to cover up his criminal  
22 conduct. Nixon did not just engage in an ill-conceived  
23 cover-up at a time when the money was already gone. Nixon  
24 was hired in March, 2007; immediately looked at whether the  
25 NewPoint offerings complied with Reg. D (they did not); and  
26 then spent nearly 2½ years providing cover to Farahi while  
27 he looted Nixon's client, NewPoint.

28 (Opp'n at 13.) See Moss v. U.S. Secret Serv., 572 F.3d 962, 969  
(9th Cir. 2009) ("In sum, for a complaint to survive a motion to  
dismiss, the non-conclusory factual content, and reasonable  
inferences from that content, must be plausibly suggestive of a

1 claim entitling the plaintiff to relief." (internal quotation  
2 marks omitted)).

3 Accordingly, the court finds that the Receiver has adequately  
4 pled the causation element for its tort claims against Nixon  
5 Peabody.

6 **III. CONCLUSION**

7 For all of these reasons, the court hereby DENIES Nixon  
8 Peabody's Motion to Dismiss.

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11 IT IS SO ORDERED.

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13 Dated: September 5, 2012

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DEAN D. PREGERSON  
United States District Judge

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