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### **Bilked investor balks at firm's deal**

*Paul Hastings asks judge to OK settlement of claims it helped client set up 'Ponzi scheme'*

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Paul, Hastings, Janofsky & Walker has asked an Atlanta federal judge to approve a settlement of a case alleging that some of the firm's Los Angeles lawyers helped clients sell investments in roving billboards that they should have realized were a scam.

The settlement filed with the court is still under seal, but a letter from an investor to U.S. District Judge Charles A. Pannell Jr. of the Northern District of Georgia hints it may top \$4 million. The investor complained that it's a poor deal for those who lost money, especially when Troutman Sanders lawyers who brought the suit on behalf of the billboard companies' court-appointed receiver would get one-third as their fee.

The suit stems from Paul Hastings' representation of Mobile Billboards of America and its affiliates, which operated a national business of billboards mounted on trucks. It claims that Mobile Billboards was a "Ponzi scheme"—a term also used by the Securities and Exchange Commission in complaints against the company—meaning that investors were repaid out of money paid by subsequent investors, not by revenues from any real business.

Mobile Billboards' troubles have reached the criminal realm. Records from a North Carolina federal court show that in January, a company founder, Michael A. Lomas, pleaded guilty to mail fraud. This month, company agents were found guilty by a jury on conspiracy and mail fraud charges.

The Atlanta suit filed against Paul Hastings in March 2006 contends that people relied on misrepresentations in the circulars reviewed by the Paul Hastings lawyers when they purchased the billboard investments.

In court filings, Paul Hastings says its lawyers didn't know at the time Mobile Billboards' promotional materials may have contained false information. The firm also notes that it warned the company that it risked SEC problems—though the suit alleges that warning came from a summer associate and that the partner overseeing her told an employee of the client to disregard her advice.

In November, the parties to the suit filed a motion asking Pannell to approve a settlement. But in the only publicly available document describing the deal, one investor says the judge should reject it.

"My stake in this (60k) may seem like peanuts to those who drew up this proposal," wrote Walter R. Lindsey of Texas last month, "but it is major to us."

Paul Hastings' outside counsel, Sutherland Asbill & Brennan partner John A. Chandler, said his client wouldn't have comment for this story.

#### **A receiver's investigation**

Daniel S. Reinhardt, one of Troutman's lawyers pressing the case against Paul Hastings, said his firm got involved because Troutman partner J. David Dantzler Jr. had done a lot of work for S. Gregory Hays, who had been appointed Mobile Billboards' receiver in another matter.

According to a Troutman associate working on the suit against Paul Hastings, Jamie L. Theriot, Hays "did a ton of investigation" that formed the basis of the suit against the firm.

It initially was filed as a class action with five investors, plus Hays, named as plaintiffs.

According to the original complaint, investors could purchase a billboard "unit" for \$20,000 for a seven-year term. An entity related to Mobile Billboards then would rent the billboards from the investors at a rate that amounted to a 13.49 percent

yearly return on their investment. Mobile Billboards agreed that it would repurchase the billboard at the end of seven years for the full purchase price.

While investors were told there were thousands of operating billboards, according to the complaint, Mobile Billboards had fewer than 200 billboards in operation and was in essence a "Ponzi scheme."

The complaint says Paul Hastings got involved in mid-2002 when Lomas wanted to make his billboard offering in California, where state regulators are especially scrutinizing. A key issue, says the complaint, is that Lomas wanted to convince state regulators that the offering was a "business offering," as opposed to a security that would be subject to more rigorous regulatory oversight and could be sold only by licensed agents.

According to the complaint, Lomas turned to long-time Paul Hastings partner Michael K. Lindsey (no relation to investor Walter Lindsey), whose profile on the firm's Web site says he "concentrates his practice in intellectual property, cyberlaw and trade regulation."

The complaint says Lindsey enlisted the help of associate Josh S. Ridout, who went on to work at Oracle and could not be reached for this story.

The complaint says that Mobile Billboards gave Lindsey and Ridout information that indicated the billboard offering was a security—including telling them that a prior submission to California regulators had been withdrawn because it appeared that the regulators would determine that the billboard investment was a security. But, according to the complaint, neither Lindsey nor Ridout consulted with any securities lawyer or did any research themselves on whether the offering was a security.

Instead, says the complaint, they recommended that Mobile Billboards form a separate company to act as the seller of the billboards in California—in part to fake out California regulators who already had seen one submission. And they made changes to the California offering materials that the complaint says contained a bevy of false information.

Along the way, the complaint says, the Paul Hastings lawyers had enough information to conclude that there was no way Mobile Billboards and the related California entity could meet its financial obligations to its investors.

#### **Warning from a summer associate**

California regulators approved the offering in the spring of 2003, according to the complaint. But Mobile Billboards still continued to ask Paul Hastings for advice, including that summer when it told the firm that it needed a letter to show sales agents that the offering wasn't subject to securities law.

According to the complaint, Lindsey gave the research assignment to Katherine A. McGowan, then a summer associate. Her July 30, 2003, memorandum had the sort of on-the-one-hand, on-the-other-hand analysis typical of law student work—saying the California billboards entity was carefully crafted so as not to "directly" constitute a security under the law but still had aspects that brought the plan into "gray areas" of the law.

But her ultimate conclusion contained a warning, as it was quoted in the complaint, that California Mobile Billboards should "take caution ... for it faces a significant risk of an enforcement action from the SEC or California Securities Commissioner."

The complaint says that Paul Hastings sent the memo to Mobile Billboards but that Lindsey "nullified" it after it created a stir at the company. Lindsey told a Mobile Billboards employee to destroy the memorandum and ignore its conclusion, according to the complaint.

In August 2004, according to the complaint, Mobile Billboards learned that the SEC's regional office in Atlanta was investigating the billboard offering. Lindsey referred that matter to one of his partners in Atlanta, Walter E. Jospin, a former SEC lawyer who chairs the local office's corporate department. The complaint says that within days Jospin concluded that the billboard offering was a security and a Ponzi scheme and promptly began negotiating with the SEC.

The SEC enforcement action was filed against Mobile Billboards in Atlanta federal court in September 2004, along with a motion consented to by the company requesting the judge to freeze the assets of Mobile Billboards and other related entities and appoint a third party receiver for the companies. U.S. District Judge Richard W. Story of the Northern District of Georgia appointed Hays as the receiver.

#### **Paul Hastings' side**

In Paul Hastings' filings, the firm says that it didn't know about its clients' fraudulent activities or that there were any misstatements or omissions in the sales material. The firm adds that it had a reasonable basis for characterizing the billboard program as a business opportunity instead of as a security.

The firm says that its work didn't relate to the operations of the billboard program—including the issue of whether there were sufficient funds for the lease payments or the promised buyback. A set of initial disclosures filed with the court says that the changes the lawyers made to the offering circular were to comply with California law and specific comments by the California attorney general's office.

Interestingly, in its initial disclosures the firm relies on the memorandum the complaint says was written by McGowan, now an associate at the firm, and disavowed by Lindsey. The initial disclosure characterizes the memo as a warning from the firm to the client and says the client ignored that warning. Even though the client sought more reassurances that it wasn't offering a security, Paul Hastings never gave those assurances, says the disclosure.

On a motion filed by the defense, Pannell dismissed the claims of those named investors who reside in Georgia (and whose claims thus are governed by Georgia law). They couldn't make out a claim for negligence, reasoned Pannell, because the promotional materials reviewed by Paul Hastings didn't identify the firm and were distributed to a large group of prospective investors—meaning the firm didn't have a legal duty to the investors. The judge concluded that another claim made by the investors—aiding and abetting fraud—didn't exist in Georgia.

But Pannell allowed most of the claims of the receiver—including professional negligence and breach of fiduciary duty—to survive the motion to dismiss.

#### **Judge to review settlement next month**

After the September 2006 ruling on the motion to dismiss, Troutman lawyers filed an amended complaint listing only Hays, the receiver, as a plaintiff. Discovery in the case proceeded, and last November the parties filed their motion asking Pannell to approve a settlement.

Most of the documents on the settlement are under seal, and Reinhardt, the lawyer who represents the receiver, declined to comment on the settlement, noting it "hasn't been finalized." But the docket sheet on the case, as well as the letter of the disgruntled Texas investor, provides some clues.

Although the investors are no longer plaintiffs and the case was never certified as a class action, the investor's letter indicates that investors can expect to receive money under the deal—apparently through the receiver. The letter says that under the proposal "we receive ten cents on a dollar."

The letter doesn't give a dollar figure, but the complaint against the law firm says that the purchases of the billboard investments exceed \$60 million and that the Mobile Billboards entities are obligated to repurchase billboard investments and make refunds in excess of \$40 million to investors who purchased the billboards after the entities engaged Paul Hastings.

A deal of 10 percent suggests that Paul Hastings—which has announced that in 2007 it grossed \$976 million, with equity partners taking home on average \$1.92 million each—would pay at least \$4 million.

Walter Lindsey, the Texas investor, told the judge in a letter that the dollar amount isn't fair, saying it might be best for a jury to hear the case.

He refers to a "Mr. Hastings," apparently confused over the nature of the defendant in the case. He also appears to have concluded mistakenly that the law firm pocketed the investors' \$60 million, writing that "[t]o let this man walk with 90 percent of our funds is not going to discourage him in the least from doing this again."

He's also not happy that Troutman apparently will get a one-third contingency fee out of the settlement. "The Defendant should pay this as he caused the problem," the investor writes.

The letter suggests that the monetary payment is conditioned on the court approving an injunction precluding purchasers from filing suit in the future. A docket entry by the court indicates the judge is being asked to issue an injunction under the All Writs Act; Pannell asked the parties to submit a brief on his authority to do so, as well as provide documentation on attorney fees.

Some filings in the SEC enforcement action provide clues as to what Pannell is being asked to do. In May 2006, U.S. District Judge Willis B. Hunt approved in that case a settlement agreement between Hays and an Ohio accounting firm that acted as auditor for Mobile Billboards. As part of that ruling, Hunt enjoined investors from suing the accounting firm over the Mobile Billboards audits, saying it was in investors' best interests because further litigation against the auditor would eat at the money available under its insurance policy.

A hearing on the motion to approve the settlement with Paul Hastings is scheduled for March 7. The Texas investor's letter suggests that investors have been told that if they want to object they have to show up in person. He says that's unreasonable.

"We are pretty strapped," he writes, "and not as young as we once were."

The case is *Hays v. Paul Hastings*, No. 1:06-CV-0754 (N.D. Ga.).



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