IN THE COURT OF COMMON PLEAS
CUYAHOGA COUNTY, OHIO

VASA ORDER OF AMERICA, *et al.*	)	**CASE NO. CV 11 753705**
	)	
Plaintiffs,	)	**JUDGE JOHN P. O'DONNELL**
	)	
vs.	)	
	)	
ROSENTHAL COLLINS	)	
GROUP, L.L.C., *et al.*	)	**JOURNAL ENTRY**
	)	
Defendants.	)	

John P. O'Donnell, J.:

STATEMENT OF THE CASE

This lawsuit was filed on April 21, 2011. A first amended complaint was then filed on August 5. Defendant Rosenthal Collins Group, LLC moved on August 26 to dismiss the first amended complaint. That motion was opposed by the plaintiffs on September 30, and the movant filed a reply brief on November 4.[1] Finally, by a filing on December 1, 2011, the plaintiffs notified the court of an October 26, 2011, opinion and judgment entry on a similar motion in the case of *Arthur J. Pieretti v. Rosenthal Collins Group, L.L.C., et al.*, Erie County Court of Common Pleas case number 2011 CV 0051. This entry follows.

STATEMENT OF FACTS[2]

Plaintiff Rolf Bergman is the grand master of plaintiff VASA Order of America, a Swedish fraternal membership organization. Plaintiff VASA Order of America National

[1] A reply brief was filed on November 3 that is identical to the reply filed November 4 except that it omitted Exhibit A to the reply brief, copies of two of the plaintiffs' investment management agreements.

[2] The court's statement of facts consists of direct quotations from the first amended complaint, reasonable paraphrases of the first amended complaint, and, where noted, references to the plaintiffs' investment management agreements.

Archives, Inc. gathers and preserves historical documents related to Swedish immigration to America. Both of the corporate plaintiffs are non-profit entities.

Enrique F. Villalba was a self-styled investment manager who never had a license to sell securities in Ohio. Villalba solicited clients by promising a superior return on their investments for nearly no risk. Beginning in 2007, the three plaintiffs separately began investing money with Villalba. Each plaintiff entered into a similar investment management agreement.

The agreements described Villalba as "the investment manager." By the contracts, each plaintiff deposited money with Villalba and gave him "full authority" to make "day-to-day investment decisions" for the plaintiffs. In particular, Villalba was given the authority to "invest and reinvest the assets in the account and . . . to make determinations as to which securities are to be bought or sold, where the securities are to be bought or sold for the account, without obtaining the consent of, or consulting with the client." The contract authorized Villalba to "select brokers or dealers to execute orders for the purchase or sale of securities," but did allow the plaintiffs to direct "brokerage transactions" to a specific broker. For his services, Villalba would be compensated with 12% or 15% of profits, depending upon the amount of assets under management.

To distinguish himself from other investment advisers, Villalba promoted what he called the money market plus method. When the plaintiffs gave their money to Villalba, he deposited it into a brokerage account opened in the name of Money Market Alternative, L.P.

The brokerage where that account was established is defendant Rosenthal Collins Group, L.L.C. Rosenthal Collins is a registered futures commission merchant with the Commodity Futures Trading Commission but is not registered to offer or sell securities in

Ohio. Rosenthal Collins earned commissions on the plaintiffs' money by acting as the clearing broker between Money Market Alternative, L.P., as buyer, and the sellers of commodity futures. Defendant Patrick D. McDonnell is Rosenthal Collins's agent who was charged with overseeing Money Market Alternative, L.P.'s account. Defendant McDonnell Futures, Inc. is a company owned by defendant McDonnell and both McDonnell and McDonnell Futures earned commissions by clearing trades made with the plaintiffs' money.

Villalba began promoting his money market plus method around 1996. However, instead of the high return/low risk investments he claimed he would make, Villalba commingled the plaintiffs' money with money from his other clients and used it to fund the Money Market Alternative account at Rosenthal Collins. He then used that account to buy and sell "speculative commodity futures contracts, including contracts for the S&P Index, Treasuries, and gold." Villalba produced regular account statements purporting to show his investors their gains and losses, but these statements were false. The false appearance of profit induced investors, including the plaintiffs, to put more money under Villalba's management.

The Money Market Alternative, L.P., account at Rosenthal Collins was opened around June, 1998, and remained there until 2009. Rosenthal Collins knew since 1998 that Villalba "was not registered as an investment adviser and that he was not authorized in any way to sell securities under any state or federal law." The defendants also "had full knowledge that Villalba was operating an illegal and unregistered commodities pool" that was not registered as required with the CFTC. Additionally, the defendants knew that Villalba was "unlawfully soliciting and commingling investor money, promoting and selling unlicensed securities . . . and speculatively trading in the firm's customer account in grossly leveraged positions." The

defendants ignored "red flags" that Villalba was "violating a host of industry regulations and state securities laws."

Eventually, in 2009, Villalba disassociated himself from Rosenthal Collins and tried to open an account with another broker. That broker recognized the likelihood that Villalba was acting illegally and declined to open an account. A short time later, Villalba was indicted and eventually pled guilty to wire fraud. He is now incarcerated in a federal prison.

THE PLAINTIFFS' CAUSES OF ACTION

Based on those facts, the plaintiffs assert seven causes of action against the defendants. First, the plaintiffs claim that the defendants are liable under section 1707.43 of the Ohio Revised Code for aiding and participating in Villalba's securities law violations. Count two is a common law claim for aiding and abetting Villalba's fraud. Count three is for civil conspiracy, *i.e.*, conspiring with Villalba to defraud the plaintiffs. Count four alleges a breach of a fiduciary duty that the defendants owed to the plaintiffs. By count five, the plaintiffs allege that defendant Rosenthal Collins violated a duty to supervise, monitor, and investigate its agents, namely defendants McDonnell and McDonnell Futures. Counts six and seven are for unjust enrichment and conversion.

LAW AND ANALYSIS

Federal preemption

As grounds for dismissing all of the plaintiffs' causes of action Rosenthal Collins posits that every claim is preempted by the federal Commodity Exchange Act, 7 U.S.C. §1 *et seq*.

It is well-established that three types of federal preemption exist, one express and two implied. *Bibbo v. Dean Witter Reynolds, Inc.*, 151 F.3d 559, 562 (6th Cir. Ohio 1998). Express preemption exists when Congress expresses a clear intent to preempt state law in the

language of the statute. *Id.* The first type of implied preemption, field preemption, is implicit where Congress indicates an intent to occupy exclusively an entire field of regulation; that intent is inferred, for example, from a federal regulatory scheme that is "so pervasive as to make reasonable the inference that [it] left no room for the states to supplement it." *Id.* The second type of implied preemption, conflict preemption, occurs either where it is impossible to comply with both federal and state law, or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" as reflected in the language, structure and underlying goals of the federal statute at issue. *Id.*

Rosenthal Collins argues that field preemption exists here.

The Commodity Exchange Act is found at 7 U.S.C. 1-27(f). Section 2(a)(1)(A) confers jurisdiction on the Commodities Futures Trading Commission "with respect to accounts, agreements . . . and transactions involving swaps or contracts of sale of a commodity for future delivery . . . traded or executed on a contract market designated pursuant to section 7 of this title or a swap execution facility." But that section also provides that "nothing contained in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any state." This suggests that Congress intended to comprehensively regulate activities directly related to commodity markets but left conduct of the participants in those markets not directly connected to a transaction open to additional federal or state regulation, including common law remedies. The CEA then is not a "regulatory scheme that is so pervasive as to make reasonable the inference that [it] left no room for the states to supplement it." *Bibbo,* supra.

Federal trial courts have concurred. For example, *Sall v. G.H. Miller & Co.,* 612 F. Supp. 1499 (D. Colo. 1985), cited by Rosenthal Collins in support of its preemption argument, involved plaintiffs suing a commodities broker they used to trade in commodity futures. Their

complaint asserted causes of action under the CEA and state law claims for breach of fiduciary duty, fraudulent concealment, constructive fraud, negligent supervision and breach of contract. The court, addressing the defendant's preemption argument, found that although the legislation was comprehensive, the "legislative history of the CEA and its amendments clearly evinces an intent to preempt *state regulation of commodities markets* but not to preempt all state common law remedies." *Id*., at 1504 (emphasis added).

If that conclusion is correct in a case brought by the broker's own customer, it is even more apt in this case, where the plaintiffs were the clients of the investment adviser and never dealt directly with the broker. As in *Sall*, the plaintiffs' state statutory and common law claims are not preempted by the CEA and the motion to dismiss on that basis is denied.

Aiding and participating in securities fraud

Count one of the amended complaint alleges that the defendants are liable for aiding and abetting Villalba's securities fraud. R.C. 1707.43 provides that "every person that has participated in or aided the seller in any way in making" a sale in violation of R.C. Chapter 1707 is "jointly and severally liable to the purchaser" for the return of the purchase price of the security or contract at issue. Rosenthal Collins first contends that it cannot be liable because the trades the defendant cleared were for commodities, which are not covered by Ohio's security laws. The plaintiffs counter that Villalba was engaged in the sale of securities, namely "investment contracts," making Rosenthal Collins an abettor even if Rosenthal Collins was only directly involved in the commodity trades made after Villalba sold the securities.

R.C. 1707.01(B) defines securities that are covered by Chapter 1707 to include "any investment contract." There is an "investment contract" when (1) an offeree furnishes initial value to an offeror, and (2) a portion of this initial value is subjected to the risks of the

enterprise, and (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise. *State v. George*, 50 Ohio App. 2d 297, 302 (10th Dist. 1975).

Here there is no question that the plaintiffs (the offerees) furnished initial value, in the form of their money, to the offeror (Villalba). It also cannot be disputed that the plaintiffs furnished that value because of Villalba's promises of exceptional profits through investment of the money. Therefore the first and third parts of the test are easily satisfied.

The second part of the test requires at least a portion of the initial value, i.e. the plaintiffs' money, to be "subjected to the risks of the enterprise." Stated another way, the question here is whether such investment would become a part of the capital pool used to conduct the business being promoted by the offeror. *George*, supra, 303. The "enterprise" of an investment manager is to invest clients' money with the expectation of receiving a return on that capital. In this case, the enterprise was Villalba's investment of the funds using his money market plus method. An inevitable feature of such an enterprise is that the funds are subjected to its risks. Despite Rosenthal Collins's suggestion to the contrary[3], there is nothing about the definition of an investment contract that requires the funds of more than one person to be pooled to satisfy this part of the test. Villalba could have conducted a single enterprise using the funds of the three plaintiffs combined or he could have conducted three separate enterprises with the separate funds of each plaintiff. As long as the money invested is subject to the risks

[3] Reply brief in support of motion to dismiss, page 4: In the instant case there is no enterprise; rather, all Villalba agreed to do was provide management services for each individual plaintiff, their money was never agreed to be pooled.

of the enterprise, which it was here, the presence of one investor is enough. Besides, as a practical matter, it is alleged that the funds of all plaintiffs were pooled. Hence, the plaintiffs have met the second part of the test.

The last part of the test can be satisfied only if the plaintiffs did not have the right to exercise practical and actual control over the managerial decisions of the enterprise. This part of the test exists because the absence of direct control over the investment by the investor is traditionally an essential feature of a "security." *George*, supra, 304. The fourth prong does not require an examination of whether the investor actually managed or controlled the investment, but whether it had the right to do so. *Pride of the Andes, Inc. v. Soberay*, 9th Dist. No. 3062-M (Jan. 10, 2001).

The investment management agreement that each plaintiff[4] had with Villalba includes provisions giving Villalba "full and exclusive discretionary authority to invest and reinvest the [plaintiffs'] assets"[5] and "complete and unlimited discretionary trading authorization."[6] The plaintiffs also gave Villalba "sole discretion, and at [the plaintiffs'] risk [to] purchase, sell, exchange, convert, tender and otherwise trade securities in the account and to act on behalf of [the plaintiffs] in all other matters necessary or incidental to the account."[7] While it is true that the agreement also allows the plaintiffs "to perform services similar to, or impacting on'[8] Villalba's responsibilities and to "designate that brokerage transactions be directed to a specific

[4] Only the agreement of VASA National Archives and a portion of the VASA agreement are part of the pleadings – as exhibits to the defendant's 11/04/2011 reply brief. It is assumed that the missing parts of the VASA agreement are the same as the VASA National Archives agreement and also that Bergman's agreement is not different. The court has considered these post-complaint filings in connection with the motion to dismiss since they should have been filed with the complaint.
[5] Investment management agreement, section II(A).
[6] Id., section X.
[7] Id.
[8] Id., section I.

broker,"[9] these terms at most create an issue of fact on the question of whether the plaintiffs had the right to exercise practical and actual control over the managerial decisions. The plaintiffs have therefore, in the context of a motion to dismiss, established the fourth prong and the defendant's argument that the plaintiffs' investment contracts with Villalba were not securities is not persuasive.

Next, because Money Market Alternative, L.P., not the plaintiffs, had an account with the defendant, Rosenthal Collins asserts that the plaintiffs lack standing to assert any claim against it. Instead, according to the defendant, any claim should be brought by Villalba's company, Money Market Alternatives, L.P. Yet Money Market Alternatives was only the nominal purchaser; it was the plaintiffs' account that was being used and the plaintiffs who incurred damages. Moreover, the defendant's position would result in the absurdity that Money Market Alternatives – an entity apparently owned by Villalba, who committed the fraud – must sue Rosenthal Collins for aiding and abetting Villalba's own fraud. It would be an injustice to leave to Villalba, the primary tortfeasor, the decision to sue to recover the plaintiffs' money from a joint tortfeasor.

Rosenthal Collins's final reason to dismiss the aiding and abetting claim is that the plaintiffs have failed to adequately plead the elements of Section 1707.43. As for this argument, the court can only note that Villalba's fraud, and the defendant's knowledge of it, are set forth in detail in the amended complaint and that the plaintiffs are not required to prove actual fraud or intent by Rosenthal Collins. (See, *e.g.*, *Fed. Mgmt. Co. v. Coopers & Lybrand*, 137 Ohio App. 3d 366, 391 (10th Dist. 2000): R.C. 1707.43 does not require that a person induce a purchaser to invest in order to be held liable. Rather, the language is very broad, and participating in the sale or aiding the seller *in any way* is sufficient to form a basis for liability

[9] Id., section II(B).

under R.C. 1707.43.) Therefore, the amended complaint adequately informs Rosenthal Collins of the claim it is expected to defend itself against.

Aiding and abetting Villalba's tortious conduct

Rosenthal Collins argues that this claim should be dismissed because it is not clear that such a cause of action even exists in Ohio, but if it does it has not been pled with sufficient particularity. Addressing the second part of this objection first, as noted above the plaintiffs have described the alleged wrongdoing sufficiently to withstand a motion to dismiss. As to the first part, the court acknowledges uncertainty about whether the cause of action is viable in Ohio.[10] However, if it does exist it certainly requires more culpability than the R.C. 1707.43 claim and discovery revealing that the defendant had no knowledge of Villalba's fraud may make it unnecessary for the court to decide whether to allow the cause of action. So, that objection can be addressed as part of a future dispositive motion but is not yet justiciable.

Civil conspiracy

In order to establish the tort of civil conspiracy, a plaintiff must prove the following elements: (1) a malicious combination of two or more persons, (2) causing injury to another person or property, and (3) the existence of an unlawful act independent from the conspiracy itself. *Kenty v. TransAmerican Premium Ins. Co.*, 72 Ohio St. 3d 415, 419 (1995). The defendant's argument against this claim is essentially factual: that Rosenthal Collins "never agreed to any such combination"[11] and "there was nothing malicious about"[12] the work it did for Villalba. But that argument is best addressed on summary judgment. In the context of a

[10] *Sekerak v. Nat'l City Bank*, 342 F. Supp. 2d 701, 716 (N.D. Ohio 2004) summarizes Ohio's conflicting decisional authority. Ultimately, the question is whether Ohio follows Section 876(b) of the Restatement of the Law 2d, Torts (1979).
[11] Br. in opp., p. 10.
[12] Id.

motion to dismiss, a review of the amended complaint shows that it sufficiently alleges facts which, if true, entitle the plaintiffs to relief from Rosenthal Collins.

Breach of fiduciary duty

Count IV of the amended complaint asserts that Rosenthal Collins breached a fiduciary duty owed to the plaintiffs by not detecting and putting an end to Villalba's fraud. The three elements of a breach of fiduciary duty claim are the existence of a duty arising from a fiduciary relationship, a failure to observe the duty, and an injury resulting proximately therefrom. *DeJohn v. DiCello*, 8th Dist. No. 94785, 2011-Ohio-471, ¶29-32. A fiduciary relationship is one in which special confidence and trust is reposed in the integrity and fidelity of another and there is a resulting position of superiority or influence, acquired by virtue of this special trust. *Tornado Techs., Inc. v. Quality Control Inspection, Inc.*, 8th Dist. No. 97514, 2012-Ohio-3451, ¶25. A fiduciary relationship may be created out of an informal relationship only when both parties understand that a special trust or confidence has been reposed. *Id.*, ¶26. Thus, a fiduciary relationship cannot be unilateral; it must be mutual. *Id.*

While Villalba and the plaintiffs were in a fiduciary relationship, Rosenthal Collins and the plaintiffs were not. Rosenthal Collins was employed by Villalba's company to clear transactions on the commodities market. Even assuming the defendant's complicity with Villalba's deception, there is nothing about Rosenthal Collins's role that suggests that the plaintiffs reposed special confidence and trust in Rosenthal Collins in particular, much less that the defendant mutually understood and accepted that trust. The plaintiffs essentially concede the lack of a separate fiduciary duty owed by these defendants by alleging, at paragraph 98 of the amended complaint, that the defendants "participated in and aided Villalba's breaches of duties owed to plaintiffs."

Count IV of the amended complaint should thus be dismissed for lack of a fiduciary relationship between Rosenthal Collins and the plaintiffs.

Negligent supervision, monitoring and investigation

The plaintiffs allege at Count V of the amended complaint that Rosenthal Collins violated "duties to supervise, monitor and investigate its agents, including Defendants McDonnell and/or McDonnell Futures." In support of the existence of such a duty in this case the plaintiffs cite to *Javitch v. First Montauk Fin. Corp*., 279 F. Supp. 2d 931 (N.D. Ohio 2003).

The primary wrongdoer in *Javitch* was Capwill. Capwill solicited investors' money and then used it to open brokerage accounts in his own clients' names at First Montauk through First Montauk's agent, Giarmoleo. The funds belonged to Capwill's clients and the accounts were in their own names. However, Giarmoleo took his instructions on the use of the money from Capwill, who then used the accounts in violation of his own duty to the clients because he had agreed to keep the investors' money in escrow. The lawsuit at issue included a cause of action by the receiver of Capwill's business entities against, among others, First Montauk for its failure to supervise Giarmoleo.

That lawsuit involves a circumstance not present here, namely a direct customer relationship between First Montauk and the defrauded investors. That distinction is enough to defeat the existence of a duty here. Under the facts alleged in the second amended complaint, this court cannot find that Rosenthal Collins undertook a duty in favor of these plaintiffs to "supervise, monitor and investigate" McDonnell and his company.

Unjust enrichment

By this cause of action, at Count VI of the amended complaint, the plaintiffs claim that Rosenthal Collins has "been unjustly enriched" and should pay restitution to the plaintiffs in the form of "all sums originally invested plus all commissions and fees paid" to Rosenthal Collins.

The elements of unjust enrichment include: 1) a benefit conferred by a plaintiff upon a defendant; 2) knowledge by the defendant of the benefit; and 3) retention of the benefit by the defendant under circumstances where it would be unjust to do so without payment. *Emswiler v. Bodey*, 2d Dist. No. 2012 CA 3, 2012-Ohio-5533, ¶50. In this case it would only be "unjust" for Rosenthal Collins to retain fees that came from the plaintiffs' money if Rosenthal Collins actually participated in the wrongdoing, i.e. if any of the plaintiffs' other substantive claims are found to have merit. But in that event the plaintiffs will already be entitled to a recovery on one or more of the alternative tort claims. Hence, the equitable claim for unjust enrichment is not an alternative theory of recovery but redundant of the tort grounds for recovery and should be dismissed.

It's also worth noting, in passing, that any benefit retained by Rosenthal would at most be equal to its fees, and not "all sums originally invested" and lost by the plaintiffs.

Conversion

The last claim in the amended complaint is for conversion. Conversion is a wrongful exercise of dominion over property in exclusion of the right of the owner, or withholding it from his possession under a claim inconsistent with his rights. *Gurry v. C.P.*, 8th Dist. No. 97815, 2012-Ohio-2640, ¶18. The elements for conversion are plaintiffs' ownership or interest in the property; plaintiffs' actual or constructive possession or immediate right to possession of

the property; defendant's wrongful interference with plaintiffs' property rights; and damages. *Id.*

Ordinarily a claim for conversion involves an identifiable piece of property, not cash. To maintain a conversion claim involving currency, a party must demonstrate that the money was (1) delivered for safekeeping, (2) intended to be segregated, (3) remained in substantially the form in which it was received, and (4) not subject to a title claim by the keeper. *FinishMaster, Inc. v. Richard's Paint & Body Shop, LLC*, W.D. Tex. No. A-11-CA-560 AWA, 2012 U.S. Dist. LEXIS 93681 (July 6, 2012).

The property the plaintiffs allege that Rosenthal Collins converted is "monies provided to Villalba."[13] This claim illustrates one of the reasons that money can only be converted under the circumstances set out in *Finishmaster*. Even if it is assumed that some of the fees paid to Rosenthal Collins were derived from the plaintiffs' cash the plaintiffs have not alleged any way to account for the amount attributable to them since they also allege that their money was commingled with other investors' money.

Count VII of the amended complaint fails to state a claim and should be dismissed.

[13] Am. comp., ¶107.

CONCLUSION

For all of the reasons given in this entry, the motion to dismiss the amended complaint filed by defendant Rosenthal Collins on August 26, 2011 is granted on the plaintiffs' claims for breach of fiduciary duty (Count IV), negligent supervision, monitoring and investigation (Count V), unjust enrichment (Count VI) and conversion (Count VII). The motion is denied on all other causes of action: aiding and abetting securities fraud pursuant to R.C. 1707.43 (Count I), aiding and abetting fraud (Count II) and civil conspiracy (Count III).

IT IS SO ORDERED:

_____ Date: _____
JUDGE JOHN P. O'DONNELL

SERVICE

A copy of this journal entry was sent by email, this _____ day of January, 2013 to the following:

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