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Hundreds Of Proposed Parties Barred From DBSI Ponzi Suit

By **Lance Duroni**

Law360, Wilmington (May 22, 2012, 9:07 PM ET) -- A Delaware bankruptcy judge on Tuesday refused to allow the litigation trustee for DBSI Inc. to add hundreds of defendants to a suit against broker-dealers that allegedly profited from the \$500 million Ponzi scheme that sank the real estate investment firm.

The trustee, James R. Zazzali, launched an adversary proceeding in November 2010 against more than 100 broker-dealers seeking to claw back \$48 million of alleged fraudulent transfers tied to the scheme. The trustee has since identified and sought to add as defendants 525 "registered representatives" for the broker-dealers who, through commissions on the sale of DBSI securities, were allegedly the ultimate recipients of a large portion of the suspect transfers.

However, at a court hearing in Wilmington, U.S. Bankruptcy Judge Peter J. Walsh denied the request, finding that the trustee failed to definitively link the original transfers to the broker-dealers and the subsequent transfers to their representatives.

Without this connection, the trustee cannot avoid the long-passed statute of limitations on the claims by showing that the proposed new defendants were aware they were potential targets when the original complaint was filed — or that the amended complaint "relates back" to the original, according to the judge.

"I'm not going to let you serve this on people who don't know what you're talking about," Judge Walsh said. "You haven't put anything on the table to show me why this amended complaint should relate back to the original complaint," he said.

Dale Barney of Gibbons PC, an attorney for the trustee, argued that the cost of discovery to link the new defendants to the original complaint would be "phenomenal," and that denying the motion would cut off an avenue to potentially \$40 million in recoveries for DBSI creditors.

"These registered representatives are the people that brought these investors to the slaughter," he said.

While Judge Walsh denied the motion, he gave the trustee 60 days to come back with more evidence that the amended complaint relates back to the original.

The case is one of dozens of lawsuits the trustee has filed on behalf of DBSI creditors seeking to claw back investments lost in the Ponzi scheme. AFA Financial Group LLC, Brecek & Young Advisors and Capital Quest Securities are among the dozens of broker-dealers targeted in the suit.

Meridian, Idaho-based DBSI and its affiliates filed for bankruptcy in November 2009, citing factors such as a "moribund" real estate market and an inability to raise capital from investors or obtain new lending to continue operations.

Earlier that month, DBSI's investors sued the firm, alleging they were defrauded of hundreds of millions of dollars, seeking damages that could run as high as \$2 billion. A liquidation plan for DBSI allowed for the creation of two litigation trusts to prosecute and settle estate and nonestate disputes.

The company's real estate business included note and bond offerings and as many as 200 tenant-in-common arrangements, under which DBSI purportedly bought shopping malls, apartment buildings and offices, and then sold property stakes to investors.

But a court-appointed examiner in the bankruptcy case discovered that DBSI's management was taking money from investors who believed they were buying interests in real estate development projects, and putting the funds toward operational expenses instead.

The trustee is represented by Dale Barney, Natasha M. Songonuga, Brian J. McMahon and E. Evans Wohlforth Jr. of Gibbons PC.

The case is James R. Zazzali v. AFA Financial Group LLC, case number 1:10-ap-54524, in the U.S. Bankruptcy Court for the District of Delaware.

--Additional reporting by Lisa Uhlman and Christie Smythe. Editing by Cara Salvatore.

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