

Joseph M. R. Covey (7492) (jcovey@parrbrown.com)
Cynthia D. Love (14703) (clove@parrbrown.com)
PARR BROWN GEE & LOVELESS, P.C.
101 S. 200 E., Suite 700
Salt Lake City, Utah 84111
Telephone: (801) 532-7840

Attorneys for Jonathan O. Hafen, Receiver

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH, CENTRAL DIVISION**

COMMODITY FUTURES TRADING
COMMISSION and

STATE OF UTAH DIVISION OF
SECURITIES, through Attorney General
Sean D. Reyes,

Plaintiffs,

v.

RUST RARE COIN, INC.; GAYLEN DEAN
RUST; DENISE GUNDERSON RUST; and
JOSHUA DANIEL RUST,

Defendants,

and

ALEESHA RUST FRANKLIN; R LEGACY
RACING INC.; R LEGACY
ENTERTAINMENT LLC; and R LEGACY
INVESTMENTS LLC,

Relief Defendants.

**MOTION TO SUSTAIN RECEIVER’S
OBJECTIONS TO CERTAIN
CATEGORIES OF CLAIMS AND TO
APPROVE OBJECTION PROCEDURE**

Civil No. 2:18-cv-00892-TC-DBP

Judge Tena Campbell

Magistrate Judge Dustin B. Pead

Jonathan O. Hafen, in his capacity as Court-appointed Receiver of the assets of Rust Rare Coin, Inc. (“RRC”), Gaylen Dean Rust (“Rust”), R Legacy Racing Inc., R Legacy Entertainment LLC, and R Legacy Investments LLC (collectively, the “Receivership Defendants”), respectfully

submits this Motion to Sustain Receiver's Objections to Certain Categories of Claims and to Approve Objection Procedure (the "Motion").

FACTUAL AND PROCEDURAL BACKGROUND

This case concerns one of the largest Ponzi schemes in Utah history. Over more than a decade, Receivership Defendants operated a purported silver investment scheme through which Receivership Defendants solicited hundreds of millions of dollars from investors. Although there were variations on the scheme, Rust represented to the majority of the investors that their funds would be pooled together for the purpose of buying and selling physical silver (the "Silver Pool").¹ Investors were told that their funds would be used to purchase physical silver to be stored in secure locations. As the price of silver began to decline, Rust claimed that he would sell physical silver and use the proceeds to subsequently purchase a larger quantity of silver at a lower price. Through this process, Rust claimed to consistently increase the number of ounces of physical silver held in the Silver Pool and, consequently, to increase the value of each investor's share of the Silver Pool.

Unfortunately, Rust's representations to investors were false. Rust never traded physical silver in the manner he described to investors. Instead, Rust used investor funds to pay returns to other investors in a classic Ponzi scheme. Rust also diverted investor funds for his own personal use and to fund other, unrelated businesses.

Upon discovering the fraudulent scheme, Plaintiffs commenced the above-captioned action on November 13, 2018. *See* Dkt. No. 1. On November 17, 2018, the Court appointed the Receiver and directed him to identify, secure, and preserve the assets of the Receivership Estate for the ultimate benefit of the Estates creditors, including the defrauded investors.

¹ For convenience, the Receiver will refer to all variations of the scheme as the Silver Pool. Based on the Receiver's investigation, all variants of Rust's investment scheme were fraudulent.

Consistent with the Court’s instruction, the Receiver and his team have been working diligently to identify and secure assets of the Receivership Estate. With approval of the Court, the Receiver has liquidated the majority of the real and personal property of the Receivership Estate. The Receiver has also filed over thirty ancillary actions seeking recovery of various fraudulent transfers and is actively negotiating with third parties to resolve other potential claims belonging to the Estate. To date, the Receiver has recovered in excess of \$10 million for the benefit of the Estate and expects to recover additional sums in the coming months.

On August 19, 2019, the Court approved the Receiver’s proposed claims procedure, claims forms, and claims notice. *See* Dkt. No. 239. The Receiver set a claims-bar date of October 4, 2019 (the “Claims-Bar Date”). The Receiver mailed over 4,000 claims forms to potential claimants and published notice of the claims process as approved by the Court. *See* Dkt. Nos. 236-3; 239. In response, over 621 claims forms were submitted to the Receiver totaling in excess of \$171 million in self-reported claims for repayment.

The Receiver has been evaluating each claim on an individual basis. For each claim, the Receiver has reviewed the claim and any included supporting documentation, reviewed documents maintained by Receivership Defendants, and determined whether the claim should be allowed, either in whole or in part. As described in the Receiver’s Motion to Approve Proposed Distribution Plan, Objection Procedure, and Claim Analysis, the Receiver intends to prepare a Claims Analysis Report (the “Report”). *See* Dkt. No. 298. The Report will identify whether each claim—or part of a claim—is allowed or disallowed, any objections to a claim, and the Receiver’s determination as to the allowable claim amount. The Receiver will serve a copy of the Report on all claimants, publish the Report on the Receiver’s website, and email a copy of the Report to all persons identified on the Receiver’s master mailing matrix.

Due to the complex nature of the Receivership Defendants' Ponzi scheme, the Receiver anticipates that his analysis of individual claims may differ from a claimant's own accounting. The Receiver also recognizes that legal and factual rulings from the Court will necessarily impact whether a particular claim will be allowed, in whole or in part. The Receiver will attempt to resolve any disputes between his analysis and a claimant's accounting directly with individual claimants. In the event a dispute cannot be resolved, the Receiver will seek a ruling from the Court, utilizing the previously approved Summary Disposition Procedure. *See* Dkt. No. 165.

In an attempt to streamline the claims resolution process, the Receiver has identified certain categories of claims the Receiver believes should not be allowed as a matter of law. The Receiver objects to these claims—or portions of claims—on a categorical basis and asks the Court to sustain those objections, as described in detail below.²

ARGUMENT

Through this Motion, the Receiver asks that the Court rule on certain categorical objections to types of claims submitted in the claims process.

The scale and complexity of Rust's Ponzi scheme created a web of financial transactions and relationships with Galen Rust at the center. Investors were encouraged to use their silver accounts like a bank account, directing Rust to pay for utility bills or for large purchases.³ Many investors would also "transfer" silver ounces between themselves in exchange for assets in the real world. Due to the fraudulent nature of the Silver Pool, there were no actual silver ounces to "transfer" and such trades were merely on paper, with no actual value exchanged. Galen Rust's

² The Receiver recognizes that there will likely be other objections to the Receiver's analysis that will require a fact-intensive inquiry and, perhaps, the weighing of competing evidence. For the purposes of this Motion, the Receiver is asking the Court to evaluate objections that are solely legal in nature.

³ For a detailed description of the Silver Pool investment scheme and the extensive interaction between Gaylen Rust and investors, *see* Declaration of Jonathan Hafen and accompanying exhibits filed in *Hafen v. Oberhansly*, Civil No. 2:19-cv-00627, Dkt. No. 19-2.

mass deception and intimate involvement in investors' financial lives created accounting problems in many contexts and has presented unique challenges in evaluating claims for repayment.

An additional layer of complexity involves the degree to which certain investors acted as intermediaries for friends and family. Because Rust promoted the Silver Pool as an exclusive opportunity offered only to those people he knew personally, many claimants did not invest directly into the Silver Pool. Rather, these third-party claimants invested through an existing investor. As a fictitious example, John was an investor in the Silver Pool. John's brother, Bob, wanted to invest in the Silver Pool but lacked the personal connection to Rust. Bob gave his money to John, who deposited the money in his own bank account and subsequently wrote a check or wired the money to Rust. As a result, the records of RRC reflect that the investment came from John's account, not Bob's. John may have acted as intermediary for several friends and family and may have pooled their investments into a single check or wire to RRC. These intermediary relationships have presented significant challenges to the Receiver's claims analysis process.

The Receiver recognizes that all of the claimants' losses are felt intensely and ultimately can be traced back to Rust's deception. However, the Receiver also recognizes that not all of the harms caused by Receivership Defendants will be able to be redressed through the claims process. The administrative burden associated with tracing all third-party transactions through intermediaries or crediting "transfers" between investors would be nearly impossible and would threaten to drain the Receivership Estate of resources. Other losses are simply not the types of losses that can be remedied through the Receivership. Detailed below are several categories of claims that the Receiver requests be categorically denied.

I. Claims Submitted After the Claims-Bar Date

Pursuant to the Court's order approving the Receiver's claims procedures, the Receiver established a Claims-Bar Date of October 4, 2019. The claims form packet that was mailed to potential claimants and posted to the Receiver's website contained a separate "Notice of Deadline to Submit Claim Form Against Receivership Estate," which expressly stated that "failure to submit a Claim Form to the Receiver prior to the expiration of the Bar Date will result in your claim being denied and you will be forever barred from asserting your claim against the Receivership Estate or any property of the Receivership Estate." *See* Dkt. No. 236-2. In addition, the Receiver published notice of the claims process and the Claims-Bar Date in several local and national newspapers. *See* Dkt. No. 236-3. Thus, potential claimants had express notice of the Claims-Bar Date and the importance of submitting a timely claim.

Despite this express notice, a handful of claims forms were submitted to the Receiver after the Claims-Bar Date. To the extent that the Receiver objects to a claim as untimely, the Receiver requests that the claim be disallowed as time barred.⁴

II. Claims for Promised "Profits" or "Gains" from the Silver Pool

A Ponzi scheme is "an investment scheme in which returns to investors are not financed through the success of the underlying business venture, but are taken from principal sums of newly attracted investments." *Jobin v. McKay*, 84 F.3d 1330, 1332 n.1 (10th Cir. 1996). The *sine qua non* of a Ponzi scheme is that returns are not generated through any legitimate business activity, but rather "returns to earlier investors were paid by funds from later investors."⁵ *S.E.C.*

⁴ There may be factual or equitable reasons why the Receiver may choose, in his discretion, not to object to a claim as untimely.

⁵ Other factors indicative of a Ponzi scheme include promises of substantial and consistent returns with little or no risk, representations that the scheme is secret, exclusive, or highly complex, and returns paid for at least some time to generate the illusion of success and to attract new investors to the scheme. *Management Solutions*, 2013 WL 4501088, at *19.

v. Management Solutions, Inc., No. 2:11-cv-1165-BSJ, 2013 WL 4501088, at *19 (D. Utah Aug. 22, 2013). It is well established that an innocent investor in a Ponzi scheme is not entitled to returns in excess of their initial principal investment amount. *See Miller v. Wulf*, 84 F. Supp. 3d 1266, 1274 (D. Utah 2015); *see also Donell v. Kowell*, 533 F.3d 762, 777 (9th Cir. 2008) (noting that amounts returned to innocent investors in excess of the initial principal investment merely “keep the fraud going by giving the false impression that the scheme is a profitable, legitimate business”).

Here, there is no dispute that the Silver Pool operated as a classic Ponzi scheme. The Receiver has discovered no evidence that Receivership Defendants traded silver in the manner represented to investors. There were no significant stores of silver in Receivership Defendants’ possession, despite representations made to investors that tens of millions of dollars’ worth of physical silver were securing their investment. To perpetuate his scheme, Rust provided regular statements to investors purporting to show increases in the value of the investor’s share of the Silver Pool.

Relying on these fraudulent statements, some claimants have sought to recover the fictitious “gains” in their investment reported by Rust. Because these “gains” or “profits” were merely on paper and did not reflect any actual increase in value based on legitimate silver trading activity, it is the Receiver’s position that claims must be limited to the total of the investor’s principal investment amount, less any distributions (the “Remaining Principal”). The Receiver requests that any claims for amounts in excess of an investor’s Remaining Principal be denied.

III. Claims for Taxes, Interest, Penalties, and Loan Repayment

In promoting the Silver Pool, Rust aggressively pushed investors to cash out or borrow from their 401(k) and other retirement accounts, to cash out their life insurance policies, and to

mortgage their homes or take out home equity credit lines to fund their principal investment in the Silver Pool. In these transactions, many investors paid taxes and penalties for withdrawing funds from their retirement accounts. Others paid interest on loans used to fund their principal investment. Some claimants have asserted that disbursements from the Silver Pool were used to pay back these loans and have argued that distributions used to pay such loans should not be included in the calculation of the investor's Remaining Principal amount. Although the Receiver recognizes that these types of taxes, penalties, and interest charges are expenses incurred by some investors as a result of Rust's deception, courts have ruled that these sorts of taxes and penalties cannot be recovered from the Receivership Estate.

First, claims for fees associated with money management such as taxes, penalties, loan fees, or interest payments are difficult to limit and define. *Donell v. Kowell*, 533 F.3d 762, 779 (9th Cir. 2008). Second, the complex tracing and questions of proof required to consider investor offsets for taxes, penalties, loan fees, and interest payments would impose an enormous administrative burden on the Receivership Estate, requiring extensive investigation into each investor's individual finances that would range far beyond the books and records of the Receivership Defendants. *Id.* Third, it would be inequitable to prioritize some investors over others simply because those investors used the funds they received to make debt payments or to pay taxes. *Id.*

For these reasons the Receiver requests that the Court categorically disallow claims to the extent they seek to recoup taxes, fees, penalties, or interest charges. The Receiver also requests that the Court not require the Receiver to evaluate the ultimate destination of funds distributed out of the Silver Pool. Rather, the proper calculation of an allowed claim is the investor's Remaining Principal (i.e., [total principal amount invested]-[total distributions paid out]).

IV. Claims for Inter-investor Transfers

As described above, Rust was intimately involved in the financial lives of investors. Rust promoted the Silver Pool as a traditional bank account and promised complete and free access to all invested funds in the Silver Pool. At times investors would make purchases for goods or services between themselves and request that ounces of silver be “transferred” to pay for those real-world goods and services. For instance, one investor sold a motorcycle to a second investor. In exchange for the title to the motorcycle, the buyer requested that \$4,000.00 worth of silver ounces be “transferred” from his account to the seller’s Silver Pool account. *See* Claim # CL0182, attached as Exhibit A. Another investor completed the staining of a cabin for a fellow investor and was credited \$14,000.00 worth of silver ounces as payment. *See* Claim # CL0184, attached as Exhibit B.

Although these “transfers” between investors were reflected on the fraudulent statements prepared by Rust, no actual value was exchanged. There was, in fact, no silver to be exchanged. Some claimants have sought to count these “transfer” amounts as additional contributions for which the claimants should be entitled to repayment. But no additional corresponding value was added to the Silver Pool as a result of these transactions. Instead, Rust simply noted the transfer on the investors’ statements. Unfortunately, to the extent these claimants wish to recover amounts they expected to receive in exchange for real-world goods and services, they will need to recover such amounts directly from the counterparty and not from the Receivership Estate. The Receiver requests that all such inter-investor transfers for which no real value was exchanged should be disregarded when calculating an investor’s Remaining Principal.

V. Claims Associated with Third-Party Investors

As described above, many investors acted as intermediaries on behalf of friends and family. Unfortunately, the books and records of the Receivership Defendants only reflect the investments and disbursements made from and to the intermediary investor and do not reflect the investment activity of the third parties. However, many of the third-party investors have sought to recoup the amounts they invested through intermediaries.

Although the Receiver recognizes the very real harms suffered by these third-party investors, these are not harms that can be remedied through the Receivership Estate. It would impose enormous administrative burdens on the Estate to evaluate these third-party transactions that are not reflected in the books and records of the Receivership Defendants. The Receiver's forensic accountants would essentially be forced to conduct the same type of analysis of the intermediaries' financial records as they have already conducted of the Receivership Defendants'.

The Receiver respectfully requests that the claims of third-party investors be denied to the extent such claims are not reflected in the books and records of the Receivership Defendants. The Receiver proposes to calculate the intermediary's allowed claim amount by relying on the books and records of the Receivership Defendants, which would not take into account any contributions from or disbursements to third-party investors. The Receiver notes that third-party investors will not be barred from seeking to recover any losses sustained through the intermediary.

OBJECTION PROCEDURE

Consistent with the Summary Disposition Procedure established by the Court, the Receiver will provide notice of this Motion to all potential claimants for whom the Receiver has

contact information and will post it on the Receiver's website (rustrarecoinreceiver.com). *See* Dkt. No. 165. Any objection to this Motion **must be sent directly to the Receiver within 30 days** of service of the Motion. An objecting party will not be a party to the overall proceeding, will not intervene in the case, and will not file any documents directly with the Court unless otherwise authorized to do so by the Court.

If an objecting party specifically requests discovery in their objection, the parties will have an additional 30 days to complete discovery. Discovery will be conducted pursuant to the *Federal Rules of Civil Procedure*, except that written discovery must be responded to within 14 days. Either side may seek relief from the Court if the requested discovery is unduly burdensome or not proportional to the issues being determined. Following the filing of the objection or close of discovery (if specifically requested), the Receiver will then file the objections with the Court and schedule a hearing on the matter. If an evidentiary hearing is needed, the Receiver will schedule additional deadlines regarding disclosure of witnesses and exhibits as needed. The Receiver may file a reply to any objection five days before the hearing.

CONCLUSION

As described above, the Receiver requests that the Court rule on certain categorical objections to types of claims submitted in the claims process. The Receiver hopes to streamline the claims resolution process by resolving these categorical objections now.

DATED this 2nd day of November 2020.

PARR BROWN GEE & LOVELESS, P.C.

/s/ Cynthia D. Love

Joseph M.R. Covey
Cynthia D. Love

Attorneys for the Receiver

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on November 2, 2020, a true and correct copy of the foregoing was (1) electronically filed with the Clerk of the Court through the CM/ECF system, which sent notice of the electronic filing to all counsel of record; (2) posted on the Receiver's website (rustrarecoinreceiver.com); and (3) emailed to all those on the master mailing matrix maintained by the Receiver.

/s/ Cynthia D. Love

Cynthia D. Love