

DAILY REPORT

A SMART READ FOR SMART READERS

An ALM Publication

In suit against lawyer, court rules that loans were securities

MILLIONS AT STAKE in case against lawyer who contends he just closed real estate deals

ALYSON M. PALMER
apalmer@alm.com

AN ATLANTA LAWYER could be on the hook for millions of dollars as the result of a recent state Court of Appeals decision about lawsuits brought by disappointed investors.

The lawyer, Charles “Mac” Cushing Jr., is being sued for his involvement in failed real estate loans. According to the July 16 appeals panel opinion, Cushing was hired by a client to incorporate the entity that made the loans and served as an officer of the company.

The decision says the loans were securities, an issue that divided trial judges handling the cases against Cushing, founding partner of the Atlanta firm now known as Cushing, Morris, Armbruster & Montgomery. That’s significant because, according to the plaintiffs, failing to register a security or obtain an exemption from that rule means investors can get their money back, plus interest and attorneys fees, from those who sold the investments to them. Although the cases have some statute of limitations challenges for the plaintiffs, their lawyers say the appellate decision means their clients are entitled to recover at least some of their losses under a state securities statute.

“When you sell securities, you have to do it in a specific way, and they didn’t,” said Atlanta lawyer David Hungeling, who represents one group of investors.

“The lesson to all lawyers is the cost of playing by the rules is not too expensive,” Hungeling added.

Cushing on Wednesday filed a motion ask-

ing the Court of Appeals to reconsider, and his lawyer, H. Lane Young II at Hawkins Parnell Thackston & Young, said that, failing that, he would ask the Georgia Supreme Court to review the matter. “I think Mac feels pretty strongly that the instruments at issue were not securities, that it was a real estate loan,” said Young. Moreover, said Young, “He wasn’t someone who was actively involved in putting deals together ... He really just did the closings.”

The cases stem from the efforts of Cushing’s client, James Ruben, to put together real estate development loans made up of contributions from a number of people. According to the appellate opinion, in the early 1990s James Ruben hired Cushing’s firm to incorporate Palmetto Capital Corp. Its purpose was to hold notes and deeds from real estate developers who borrowed the investors’ money.

When Ruben had a sufficient number of investors, he would tell them to send their investment to Cushing’s firm, which held the funds in escrow, prepared the closing documentation and closed the deal.

In 2003, a financial adviser for one of the investors asked Ruben whether the promissory notes were actually securities, which would mean that they would be subject to government regulation. When Ruben asked Cushing about that, Cushing hired an expert in securities law, identified by lawyers in the case as Atlanta attorney R. Harold “Hal” Meeks Jr. of James Bates Brannan Groover, to give a legal opinion on the matter. Meeks concluded it was “highly likely that a court would deem these loan participations to be securities,”



JOHN DISNEY/DAILY REPORT

David Hungeling, representing one group of investors, says certain rules must be followed in selling securities.

according to the appeals court ruling. He also concluded that the transactions were illegal because Ruben was paying himself commissions but wasn’t registered as a securities dealer or salesperson under Georgia law.

Ruben asked Cushing what Palmetto could do to comply with the law. As recounted by the appeals court, Cushing said that although Palmetto could seek to qualify for a “private

placement” exemption from securities laws, the fees the investors paid to Palmetto might affect the company’s ability to qualify for such an exemption. He concluded the structure of the deals meant Palmetto couldn’t get an exemption and recommended Ruben rely on the two-year statute of limitations as protection against any future securities claims.

Ruben pressed on with a new program in 2004, pooling investors’ money with funds Palmetto borrowed directly from a commercial bank. Ruben then loaned the money to high-risk developers at an interest rate higher than the bank’s rate, according to the appeals court, allowing Palmetto to deliver high returns to the investors. Palmetto made three loans at issue in the lawsuits against Cushing, meant to purchase hundreds of acres of property in Douglas, Bartow and Fulton counties. At stake was \$14.9 million from 141 individual investors with \$25,138,000 million from Nexity Bank.

Palmetto didn’t tell the investors that it had borrowed the money from the bank then loaned the money to the developers. Instead it told investors that the bank had made separate direct loans to the developers.

In emails to investors, the appeals court said, Palmetto touted its skills in selecting the deals and managing them afterward. In an email to potential investors about one of the deals, Ruben said “the return is close to those flying their product over the Everglades, tonight” (apparently, the appeals court said, a reference to drug smugglers).

Ruben, who had become increasingly physically disabled due to Lou Gehrig’s disease over the course of more than a decade, died in 2007. That same year, all three developers defaulted on their loans, which caused Palmetto to default on the payments due to the investors.

Two sets of investors in 2009 sued Cushing, Palmetto and Mary Alice Ruben, both individually and as the executor of her late husband’s estate.

One group of plaintiffs, represented by John Porter Jr. of Atlanta’s Smiley Bishop & Porter, are members of the family of Atlanta physician Sheldon Cohen, who say they invested a total of \$1,265,000 in the three deals.

Hungeling’s clients are Atlanta criminal defense lawyer Mark Scheinfeld, an investment company and a profit-sharing trust for a Georgia real estate company, who say they together invested \$1,727,700.

In both cases, the plaintiffs bring claims for



John Porter Jr.

breach of fiduciary duty and negligent misrepresentation. They also bring claims under the Georgia Securities Act, contending the defendants are liable for the failed deals because they were selling unregistered securities without a license. They say they are entitled to a return of their principal, plus interest and attorney fees.

A key issue in the case, and a focus of the appeals court decision, is whether the investments were securities such that they could give rise to liability under the Georgia statute. Statutory claims over at least some of the investments may present statute of limitations problems for the plaintiffs. But, according to the plaintiffs’ lawyers, liability under the Georgia statute is strict—that is, if the investments weren’t registered as securities with the state, the plaintiffs don’t have to show any other elements, such as the defendants having made misrepresentations to them, in order for the defendants to be liable.

Last year, Fulton County Superior Court judges hearing the two cases issued divergent summary judgment rulings on the securities issue. Judge John Goger ruled in the Cohens’ case that the investments were securities under the Georgia law, saying the investors reasonably expected to make money on the deals based on the efforts of others.

Ruling on Scheinfeld’s case, Judge Constance Russell said the deals were not securities, pointing to the investors’ knowledge of the individual borrowers and real estate at issue and the lack of value that Palmetto added to the process.

The other defendants were not part of the appeals decided last week. Mary Alice Ruben and her husband’s estate have raised their own claims against Cushing and his firm, according to Hungeling.

Each side appealed the decision that went against it. At the Court of Appeals, the plaintiffs were backed by an amicus brief filed by Attorney General Sam Olens on behalf of Secretary of State Brian Kemp. Kemp argued that, in order to protect investors, the court should follow precedent and hold that the notes at issue in the case are securities.

The panel of Judges Anne Elizabeth Barnes, M. Yvette Miller and William Ray II sided with the plaintiffs and the secretary of state. Barnes wrote that the inves-

tors reasonably expected profits derived from the managerial efforts of others, one element of a security, citing Palmetto’s marketing of the products.

“The leveraged lending that combined the investors’ money with the bank’s money to generate a high rate of return was not a straightforward pass-through loan,” wrote Barnes. “The profits would be based on Ruben’s skill in selecting the deals in the first place, managing the loans as time went on, and salvaging the capital if the borrowers defaulted. These investments thus meet the definition of security.”

Despite Cushing’s contention that he had no responsibilities as Palmetto’s corporate secretary and was just the closing attorney on the transactions, the panel found that he could be jointly and severally liable for the sale of unregistered securities, because under the statute every executive officer of an entity that sells unregistered securities is jointly and severally liable. Barnes also rejected Cushing’s argument that Goger erred on a couple of statute of limitations issues.

According to Hungeling, the decision allows the plaintiffs to obtain a judgment on some of the securities claims, with other issues still to be litigated. “It’s basically a partial victory,” he said.

Young, the defense lawyer, said Cushing is seeking further review of the securities and statute of limitations issues. He said multiple lawyers, including defense expert witness Howell Hollis III of Smith Moore Leatherwood in Atlanta, had given their opinion that the deals weren’t securities. Young added that the conflicting expert opinions didn’t control the case.

“We’re going to have to assess the cases after the appellate process ends to see what remains to be decided,” Young added.

Porter, the lawyer for the other group of plaintiffs, said the import of the Court of Appeals decision is clear: “In Georgia, if it looks like a security and is marketed like a security, and outside counsel advises you it’s security, it’s a security, and you should comply with state or federal securities laws in selling it.”

The cases are *Cushing v. Cohen*, No. A13A0736, and *Scheinfeld v. Cushing*, No. A13A0820. 