



Anticipating the Flood of GPB Litigation in the Midst of the COVID-19 Pandemic

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GPB Capital Holdings, LLC (GPB), with its affiliates, is the latest failure of a multi-billion dollar private placement investment sponsor. GPB's implosion tracks the classic meltdown model: there was an investor capital raise of over \$1.8 billion followed by a barrage of lawsuits for corporate control, multi-front investigations by governments and regulators, whistleblowers signaling egregious mismanagement, an abrupt halt in sales and capital distributions and class action lawsuits for securities fraud. By size alone, GPB's collapse is among the biggest, yet the amount of harm remains a mystery because audited financials and fund valuations are masked in secrecy and the SEC has not moved for a receiver to run GPB.

The fallout from the failure of any private placement investment sponsor touches all corners of the securities industry in different ways. Customers and securities firms are in the dark about the current value of their GPB investments. A flood of litigation will ensue. Insurers and securities firms must brace for a swell of claims and risk exposure.

In the traditional scenario, broker-dealers defend FINRA arbitration actions from retail customers while investment advisory firms face private arbitration and civil court actions. Meanwhile, GPB's affiliates, partners and vendors brace for all of the above – private arbitration and court civil actions from everyone harmed by GPB's failure.

GPB is the first investment sponsor to face a flood of litigation during the COVID-19 coronavirus pandemic. This article explores the litigation strategies expected to emerge as the wave of GPB-related litigation rolls in during the Covid-19 pandemic.

GPB in Context

GPB was founded in 2013 as an alternative asset management firm that sold interests in limited liability partnerships operating car dealerships and waste management businesses. Its founders were Jeffrey Schneider, David Gentile and Mark Martino. GPB partnered with securities firms to sell GPB's interests to retail customers across United States.

GPB appeared successful at the outset. It filed disclosures with the SEC, conducted annual financial audits and reported regular income distributions to investors. Its distribution partner, Ascendant Capital Management, LLC (Ascendant), structured the GPB funds and raised capital for GPB. Ascendant created an appearance of prosperity by promoting its capital raise successes, by offering a stable 8% annual income payment to investors and by showcasing its funds' annual audited financial statements. GPB was vetted by more than sixty securities firms and passed their due diligence processes to be offered for sale to retail investors. Many of the brokers' registered representatives found GPB an attractive option for retail investors.

Cracks in the Facade

Cracks in the façade began to emerge. GPB embroiled itself in litigation with former officers and industry partners, many of which provided information about the firm's alleged dysfunction.

In July 2017, GPB sued Patrick Dibre, a former operating partner, in New York state court for torts and contract claims involving the failed sale of various car dealerships.¹ On March 19, 2018, Dibre, in a counterclaim, described GPB as a "Ponzi scheme" and blamed it for not funding the dealership sales.

A series of GPB's auditors then resigned by "noisy withdrawal" and previously audited financials were withdrawn.² Auditor RSM US LLP was the first, withdrawing the 2015 and 2016 financial statements for GPB's businesses.

GPB's replacement auditors have been unable to repair the damage at GPB. The 2015 and 2016 audits have not been corrected and ongoing audits have been extensively delayed with the blame put on GPB's uncooperativeness, leaving investors in the dark about the value of their investments.

Meanwhile, in August 2018, GPB temporarily halted raising new money and suspended redemptions by investors. In September 2018, the Massachusetts Securities Division launched an investigation into 63 independent broker-dealers that sold GPB interests.³ By December 2018, GPB halted the distributions to investors and forecasted that its funds had declined in value by 25% to 70%, a range so wide that it did nothing to quell the rising concern among investors and regulators. Investigations by the SEC, FINRA and the State of Massachusetts commenced, which were reported in the news in December 2018.

On February 28, 2019, the Federal Bureau of Investigations entered GPB's offices in what GPB reported as an "unscheduled visit"⁴ or what is more commonly known as a raid.

continued.

Against this backdrop, the first class-action lawsuit against GPB was filed in the United States District Court in the Western District of Texas in October 2019.⁵ The case was filed by an investor class against GPB, along with its principals and affiliated funds, its auditors and administrators and approximately 60 broker-dealers that sold GPB to retail investors.

According to the class action complaint, GPB created a series of holding companies and faulty accounting and auditing procedures to run the alleged scheme. It described GPB as “destined to fail,” and fraught with “gross conflicts of interests, undisclosed prior bad acts, and registration failures.”⁶ The complaint alleges the characteristic of a *Ponzi* scheme by stating that 8% annual returns were not generated by investments in auto dealer or other business, but instead were the return of new investors’ capital to the older rounds of investors.

This cascade of negative news shined a spotlight on Schneider’s and Martino’s securities industry checkered past of workplace separations, adverse regulatory actions and customer disputes, none of which were helpful to GPB’s facade.

GPB is also now at the center of a coming wave of individual customer cases against securities firms for their sales practices in individual retail investor transactions.

The Way Out: Early Resolution

The liability exposure for securities firms that sold GPB to retail customers is unpredictable as no customer awards are yet a matter of public record. Defenses to liability in GPB customer claims remain viable – third party fraud, reasonable due diligence, superseding and intervening acts after the sales and statutes of limitations barring the earliest sales.

Securities firms would be well served to evaluate all GPB exposure risks and to develop a meaningful defense strategy for each type of risk. Securities firms should also promptly tender all GPB claims and prospective claims to their professional liability insurer before the policy period ends since GPB will very likely be on the excluded product list going forward in next years’ policy period.

With current court backlogs, arbitration postponements, and the possibility of an SEC-appointed receivership, the uncertainties in the legal system caused by the Covid-19 pandemic create opportunities for early resolution of investor claims. In fact, many investors who are already concerned

about GPB are currently without counsel and in a “wait and see” mode trying to determine what the future holds for GPB and the stock market overall. It is foreseeable that if the stock market declines, retail investors will flock to counsel to file GPB claims and portfolio loss claims. There is also a risk that if the markets maintain the course, the smaller GPB claims will be bundled into multi-party claims under the strength in numbers theory.

As for insurance carriers, absent policy exclusions, insurers owe defense and indemnity coverage to the insured securities firms.⁷ Over the next few months, insurers and insureds should work closely to assess the risk exposure and the available policy limits to dispose of GPB claims. Fire-sale deals happen in volatile times and the opportunity for these types of deals will peak in the next several months.

Regardless of one’s position in the GPB saga, it is important to remember that the pandemic will pass, but the decisions made within it will last. This is not a time for paralysis or rash action. A reasoned approach to the coming year will serve everyone as we move through this challenging time.

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¹GPB Capital Holdings, LLC et al v. Patrick Dibre, in New York State Supreme Court, Nassau County, Index No. 606417/2017 (Jul. 2017)

²Bruce Kelly, A Crisis of Confidence Surrounds GPB Capital, Investment News (Jul. 30, 2019), at <https://www.investmentnews.com/a-crisis-of-confidence-surrounds-gpb-capital-80640>

³Massachusetts Regulator Sweeps 63 Broker-Dealers Selling GPB Private Placements, The DI Wire (Sept. 13, 2018), at <https://thediwire.com/massachusetts-regulator-sweeps-63-broker-dealers-selling-gpb-private-placements/>

⁴Letter from David Gentile, CEO, of GPB Capital Holdings, LLC dated March 1, 2019, at https://thediwire.com/wp-content/uploads/2019/03/GPB_Capital_Company-Update_March_2019.pdf

⁵Kinnie Ma Individual Retirement Account, et al. vs. Ascendant Capital, LLC, Case No. 1:19-cv-01050-LY (W.D. Tex. Oct. 25, 2019).

⁶Id.

⁷Insurance policies must be evaluated on a policy by policy basis.