IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	
	§	Case No.: 3:09-cv-0298-N
	§	
STANFORD INTERNATIONAL BANK, LTD., STANFORD GROUP COMPANY, STANFORD CAPITAL MANAGEMENT, LLC, R. ALLEN STANFORD, JAMES M. DAVIS, LAURA PENDERGEST-HOLT,	§ § § § §	
	§	
Defendants,	§	
and	§	
	§	
STANFORD FINANCIAL GROUP COMPANY and THE STANFORD FINANCIAL GROUP BLDG INC.,	§ §	
	§	
Relief Defendants.	§	
	§	

PLAINTIFF'S OPPOSITION TO
<u>STANFORD'S SECOND MOTION TO DISMISS FRAUD-BASED CLAIMS</u>

Dated March 11, 2010

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Stanford's second motion to dismiss should be denied. First, the Commission's Second Amended Complaint alleges misconduct squarely within the Court's subject matter jurisdiction. Stanford, using United States-based investment advisers, defrauded thousands of United States investors of billions of dollars through a private placement that was registered with the Commission. Notably, the defendants assured investors that, by offering them the CD, SIB and its officers were subjecting themselves to scrutiny under the antifraud provisions of the federal securities laws. It is irrelevant that Stanford called his investment product a "certificate of deposit" or that the offering was putatively issued by a sham bank in an offshore jurisdiction, where Stanford enjoyed the protection of a corrupt "regulator." Second, the Commission's allegations against Stanford detail the "who, what, when, where, and how" of his fraud and demonstrate his *scienter*. To name only one such instance, the Commission alleges that Stanford misappropriated billions of dollars of investor funds, that he covered that up by signing promissory notes that were not disclosed to investors, and that he signed specific annual reports that reflected investment returns that he falsified. Finally, Stanford's venue challenge is baseless and fails to acknowledge that he has extensively litigated this case in the Northern District or that his company, Stanford Group Company, maintained an office in Dallas.

I.
<u>FACTUAL BACKGROUND</u>

Stanford, through companies he controlled, including Stanford International Bank, Ltd ("SIB") and its affiliated broker-dealer and investment adviser in the United States, Stanford Group Company ("SGC") and Stanford Capital Management ("SCM"), executed a massive Ponzi scheme. [Second Amended Complaint ¶¶ 1, 13, 26] This scheme entailed selling self-styled "certificates of deposits" ("the CD") touting SIB's (i) safety and security; (ii) consistent double-digit returns on its investment portfolio; and (iii) high return rates on the CD that greatly exceeded those offered by commercial banks in the United States. [Id. at ¶ 2] In selling the CD, SIB aggregated customer deposits and then purportedly reinvested those funds in a "globally diversified portfolio" of assets. [Id. at ¶ 31] Pursuant to a private placement made under the Securities Act of 1933's Regulation D, SIB sold the CD to U.S. investors through SGC, which Stanford owns and which is registered with the Commission as a broker-dealer and investment adviser. [Second Amended Complaint ¶¶ 13, 14, 26, 27] In connection with the private placement, SIB filed several Forms D with the Commission. [Id. at ¶ 27] As part of the effort to lure investors into buying the CD, Stanford and others provided to investors materially false and misleading information.

As part of the scheme, SGC employed a generous commission structure to recruit established financial advisers and provide those advisers a powerful incentive to aggressively sell the CD. [Id. at ¶¶ 28-29] As a result of these efforts, investors were lured into converting (i.e., selling) existing stocks, bonds and similar securities into investments in SIB's CDs. From August 2008 through December 2008 alone, approximately 50 SGC clients liquidated at least $10.7 million in stocks, bonds and similar securities and invested the resulting money in SIB's CDs. [*See* Appendix in Support of Motion for Ex Parte Temporary Restraining Order, Preliminary Injunction, and Other Emergency Relief ("TRO App"), Docket No. 7, at page 593]

Although SIB was incorporated under the laws of Antigua, neither it nor the CD was, in reality, subject to regulatory oversight in that jurisdiction. Instead, Leroy King, the administrator and chief executive officer of Antigua's Financial Services Regulatory Commission (the "FSRC"), facilitated the Ponzi scheme by ensuring that the FSRC "looked the other way" and conducted sham audits and examinations of SIB's books and records. [Id. at ¶ 6] In exchange for bribes paid to him over a period of several years, King made sure that the FSRC did not examine SIB's investment portfolio. [Id.] King also obstructed the Commission's investigation by providing Stanford with access to the FSRC's confidential regulatory files and allowing Stanford to dictate the substance, and even content, of the FSRC's responses to Commission's requests for information to the FSRC. These responses relayed false assurances that there was no cause for concern as to SIB and withheld information requested by the Commission that would have revealed Stanford's fraud. [Id.]

Ultimately, as a result of his fraudulent scheme, Stanford was able to misappropriate for his personal use billions of dollars of investor money. [*See, e.g.*, id at ¶ 3].[1]

II.
<u>ARGUMENT</u>

A. STANFORD'S FRAUD FALLS SQUARELY WITHIN THE COURT'S SUBJECT MATTER JURISDICTION.

Stanford asks this Court to excuse his fraud, arguing incorrectly that because he labeled his product a "certificate of deposit" and sold it under the name of an entity organized under the laws of Antigua, his conduct is not covered by the federal securities laws. [See Memorandum of Law at 5-6] This argument is particularly specious when read in the context of past assurances to investors that "[b]y making this offering to Accredited Investors in the United States, SIBL and its officers are subject to certain laws of the United States, including the anti-fraud provisions of the U.S. federal securities laws and similar state laws." [TRO App. at 888]. Stanford's argument ignores the facts, is contrary to law and should be rejected.

As a threshold matter, Stanford wholly ignores the fact that, as a result of the aggressive compensation structure his company SGC provided to financial advisers, investors were lured into converting (i.e., selling) existing stocks, bonds and similar securities into investments in SIB's CDs. From August 2008 through December 2008 alone, approximately 50 SGC clients liquidated approximately $10.7 million in stocks, bonds and similar securities and invested the resulting

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[1] Additional factual background, including misrepresentations and fraudulent conduct identified in the Second Amended Complaint, are discussed below.

money in SIB's CDs. [*See, e.g.*, Second Amended Complaint at ¶¶28-29; TRO App at page 593][2] Stanford's fraud, then, led these investors to sell their existing securities, easily satisfying the "in connection with the offer or *sell* of security" jurisdictional element. *See, e.g., SEC v. Zandford*, 535 U.S. 813, 825 (2002) (holding that the "in connection with" element is satisfied by a "fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide") (emphasis added).

In any event, Stanford's simplistic mantra that certificates of deposit are presumed exempt from the federal securities laws is wrong. The Supreme Court has made clear that **"**Congress's purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called." *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990). Moreover, all notes – including products such as the "certificates of deposits" sold in this case – are presumed to be securities. *Id.* at 64 (1990).[3]

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[2] It is well-established that a pleader may establish the actual existence of subject matter jurisdiction through extra-pleading material. *See, e.g., Williamson v. Tucke*r, 645 F.2d 404, 413 (5th Cir. 1981); *LaFargue v. U.S.*, 4 F. Supp.2d 580 (D.C. La. 1998) (noting that district court may base its decision on the complaint alone, the complaint supplemented by undisputed facts evidenced in the record, and the complaint supplemented by undisputed facts plus the court's resolution of disputed facts.) At the same time, of course, it is well-settled that the complaint will be construed broadly and liberally.

Here, the evidence that Stanford's U.S. investment advisers lured U.S. investors to sell stocks, bonds and other securities they owned in order to invest the proceeds in SIB's CD has stood undisputed since the day this case was filed. Instead of disputing this evidence, it, Stanford invoked his Fifth Amendment privileges and did not appear to contest the entry of a preliminary injunction against him. In fact, SGC's reliance on the Regulaton D private placement, in effect, precluded SGC employees from selling the purported CD to anyone but clients with whom they already had pre-existing relationships (i.e., clients that purchased securities through an account managed by the SGC representative. There is no basis to question the fact that investors sold certain holdings in order to fund CD purchases and that they sold those securities in connection with the fraud alleged in the Second Amended Complaint. This provides an independent basis for subject matter jurisdiction over the Commission's claims against Stanford.

[3] Stanford's reliance on *Marine Bank v. Weaver*, 455 U.S. 551 (1982) is mistaken. There, the Supreme Court made it clear that a certificate of deposit – even certificates issued by legitimate operations – does not invariably fall outside the definition of a 'security." Instead, "each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole." *Id*. at 551, n11. This caution is particularly important here, where the allegations are, and the evidence confirms, that the so-called "certificates of deposit" were sold using United States-based investment advisers and purposefully designed to avoid regulatory scrutiny and were not subject to regulatory scrutiny in Antigua. As discussed above, for this and other reasons, Stanford's reliance on a footnote in *Callejo v. Bancomer SA*, 764 F.2d 1101, 1125 n.33

This presumption may be rebutted only by a showing that the note bears a strong resemblance to certain enumerated non-securities such as "the note delivered in consumer financing, the note secured by a mortgage on a home, the short term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business." *Reves*, 494 U.S. at 65. To determine whether such resemblance exists, the Supreme Court has applied a "family resemblance test," instructing that it is necessary to analyze the following four factors: (1) the motivation of the parties; (2) the plan of distribution; (3) the reasonable expectations of the investing public; and (4) the existence of factors which would reduce the risk of the instrument. *Id*. Notably, no one factor by itself is dispositive. *Id*.

Applying this standard, SIB's CD product is a security. In *Reves*, the Supreme Court confirmed that, if the seller's purpose is to finance substantial investments and the buyer is interested primarily in the profit the instrument is likely to generate, the instrument is likely to be a security. *Id*. at 66. That is precisely the situation here. [*See, e.g.* Second Amended Complaint at ¶ 2, noting that SIB touted high return rates to investors and at ¶ 26, noting that SIB's primary product is the CD] Likewise, when the issuer solicits individuals, that indicates "common trading" and weighs in favor of finding the instrument a security. Again, that is the case here, where SIB, acting through its affiliated investment adviser and broker-dealer routinely solicited individuals via retail investments. [See Second Amended Complaint at ¶ 26; TRO App. 593, 668].

(5th Cir. 1985) and the Ninth Circuit's decision in *Wolf v. Banco Nacional de Mexico*, 549 F. Supp. 841, 843 (D. Cal. 1982), overruled on other grounds, 739 F.2d 1458, 1462 (9th Cir. 1984), is misplaced.

Third, as noted above, the public reasonably viewed these instruments as securities investments. Importantly, in *Stoiber v. SEC*, 161 F.3d 745, 750 (D.C. Cir. 1998), the D.C. Circuit Court held that courts should consider instruments to be securities on the basis of public expectations, "even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not securities as used in that transaction." Indeed, the public's reasonable view is "a one-way ratchet" that "allows notes that would not be deemed securities under a balancing of the other three factors nonetheless to be treated as securities if the public has been led to believe they are. It does not, however, allow notes which under the other factors would be deemed securities to escape the reach of regulatory laws." *Id.* at 751.

Here, there can be no doubt that the public reasonably viewed the CD as a security investment. The CDs were sold to United States investors through United States-based investment advisors at SGC, an entity registered with the Commission as a broker-dealer and investment adviser. [Second Amended Complaint at ¶ 14]. SIB's Forms D, filed with the Commission, explicitly provided investors with a "Notice of Sale of Securities." [See Second Amended Complaint at ¶ 27; TRO App. at 0906]. Investors were told that SIB, which was not like a normal bank and did not make loans, instead invested their money in a "globally diversified portfolio" to generate higher than normal investment returns. [See Second Amended Complaint at ¶¶ 13, 31, 32] Most tellingly, SIB and Stanford further assured United States investors that the offer and sale of the CD was subject to the antifraud provisions of the federal securities laws. [TRO App. at 888]. In this context, particularly when investors bought CDs by selling existing holdings in stocks, bonds and other securities, what else would investors have reasonably assumed?

Ignoring this reality, and the particular importance of public expectation, Stanford focuses on a single factor – putative oversight by the financial regulator in Antigua. Clutching to the fact that SIB was organized under the laws of Antigua, Stanford contends that the Commission "presumably recognizes that SIB, an Antigua-based bank, was subject to Antigua's laws and regulations, but it has made *no* allegations, presented *no* facts, and made *no* arguments about the state of Antiguan banking regulation or Antigua's oversight of SIB." [Memorandum of Law, Docket No. 1019, at 6, emphasis in original] Nothing could be further from the truth.

The Second Amended Complaint is quite explicit regarding the state of Antigua's oversight of SIB: it was non-existent, and, in fact, was used to facilitate the fraud.[4] Moreover, according to the FSRC, the regulatory agency in Antigua that putatively provided oversight of offshore banks like SIB, its oversight did not include obtaining independent verification as to the amount of SIB assets reflected on statements of sub-custodians. Instead, confirming SIB's financials was a task to be performed by SIB's internal and external auditors. [See TRO App. at 0675].[5] This case stands in stark contrast to cases such as *Wolf* and *Callejo*[6], in which the decision to exclude certificates of deposits issued by Mexican banks from the scope of the federal securities laws "was based

4 Citing *West v. Multibanco Comerex, S.A.*, 807 F.2d 820, 827 (9th Cir. 1987), Stanford argues that "[o]vergeneralized claims that foreign authorities were 'not enforcing' foreign bank regulations are beside the point and should be disregarded." [Memorandum of Law at 6] The Commission does not believe the law requires the Court to ignore those allegations. *See, e.g., Bradford v. Moench*, 670 F.Supp. 920, 934 n.30 (D. Utah 1987) (noting that the court did not necessarily accept the position of *West* as to the scope of the inquiry on the extent of foreign regulation). At a minimum, the Commission submits that it would be premature to grant a motion to dismiss without further consideration of the scope of regulatory oversight of SIB. Moreover, even if the Court does not consider the fact that the Antiguan "regulator" actually facilitated the fraud rather than regulating SIB, the record to date makes it clear that the Antiguan regulation is a far cry from providing the "virtual guarantee" that led Courts' to exempt certificates of deposits issued by Mexican banks from the scope of the federal securities laws.

5 In fact, this lack of transparency into SIB's financials led SGC's clearing broker to stop processing wires from SGC accounts at the clearing broker to SIB for the purchase of SIB CDs. [TRO App. at 0675]. It is clear that the Antiguan system did not provide the type of regulatory oversight necessary to remove SIB's CD from the scope of the federal securities laws.

6 *Wolf v. Banco Nacional de Mexico*, 739 F.2d 1458 (9th Cir. 1984) and *Callejo v. Bancomer SA*, 764 F.2d 1101, 1125 n.33 (5th Cir. 1985).

primarily on the 'insolvency protection' provided by the system of Mexican regulation governing the operation of its banks," including "'preferential' legal status for claims against insolvent banks." In short, in those cases, courts were persuaded that the Mexican regulatory system provided safeguards such that investors were 'virtually guaranteed' of repayment in full to the same degree as those in United States banks." *West v. Multibanco Comerex, S.A.*, 807 F.2d 820, 827 (9th Cir. 1987), citations omitted.[7] Therefore, under those facts, additional regulatory scrutiny from the United States was unwarranted.

In contrast, SIB, which unlike commercial banks that generally make profit through making loans, is different than the banks at issue in cases such as *Wolf*. In fact, as it admits in various offering documents, its customers assume the risk of SIB's insolvency. Specifically, according to the bank's own materials, "the ability of SIB to repay principal and interest on the CD Deposits is dependent on our ability to successfully operate by continuing to make consistently profitable investment decisions" and "you may lose your entire investment." [TRO App. 890]. This is precisely the sort of risks the antifraud provisions and other protections of the

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[7] *Reves* is critical to properly applying whatever lessons are given by *Wolf* and *Callejo*. Both *Wolf* and *Callejo* pre-date *Reves*. In *Reves*, the United States Supreme Court emphasized that the relevant question in applying the fourth factor was whether the product at issue was subject to the strictures and protection of alternate *federal* regulatory system, such as FDIC protection. 494 U.S. at 69. (citation omitted and emphasis added). Antigua's regulatory regime is not a United States federal regulatory system. For example, in evaluating this factor after *Reves*, the Tenth Circuit noted that regulation by a state is not enough. *See also Holloway v. Peat, Marwick, Mitchell & Co.*, 900 F.2d. 1485, 1488 (10th Cir. 1990), *cert. denied*, 498 U.S. 958 (1990) (holding that the Supreme Court in *Reves* clearly required an alternative *federal* regulatory system); s*ee also Bradford v. Moench*, 809 F. Supp. 1473, 1483 (D. Utah 1992) (following *Holloway* decision and holding Utah regulatory system cannot serve as risk reducing factor). That SIB may have also been, in theory, subject to certain Antiguan laws does not mean that the federal securities laws do not apply. It should also be noted that the Commission – the primary agency responsible for determining whether the securities laws cover certain instruments – has applied the Securities Act to instruments the offering party claimed were similar to certificates of deposits, despite the existence of certain oversight by a foreign regulator. *See In the Matter of State Bank of Pakistan*, Admin Proc. File No. 3-7727, 1992 SEC Lexis 1041 (May 6, 1992)

federal securities laws were designed to address. Stanford's motion to dismiss should, therefore, be denied.[8]

B. THE SECOND AMENDED COMPLAINT MEETS AND EXCEEDS THE STANDARD TO STATE A CLAIM.

Stanford argues that the Commission's claims against him for violating Section 10(b) and Rule 10b-5 of the Securities Exchange Act, Section 17(a) of the Securities Act of 1933 and Section 206 of the Investment Advisers Act of 1940 should be dismissed because, according to Stanford, the Commission has not adequately alleged Stanford's fraudulent conduct or *scienter*. Stanford also complains that the Commission's claims under the Advisers Act should be dismissed because, he claims, the Commission has not alleged he was acting as an investment advisor. None of these arguments has merit.

1. Legal Background

To establish liability under Section 17(a), 10(b) and Rule 10b-5, the SEC must allege: (1) a fraudulent device, material misrepresentation or omission, or an act that operated as fraud or deceit, (2) in connection with the purchase or sale of securities, and (3) scienter. *SEC v. Gann*, 2008 WL 857633, at *9, Fed. Sec. L. Rep. P 94,631 (N.D. Tex. Mar. 31, 2008).[9] In addition, scheme liability is imposed on persons who use deceptive devices in the purchase or sale of securities. *See, e.g., Regents of the Univ. of California v. Credit Suisse First Boston*, 482 F.3d

[8] Even if the Court were to conclude that the CD was not a "security" for purposes of the federal securities laws, the Commission's claims related to the CD against Stanford under Sections 206(1) and 206(2) of the Advisers Act (15 U.S.C. §§ 80b-6(1) & 80b-6(2)) would remain. Unlike the antifraud provisions of the Securities Act and the Exchange Act, Sections 206(1) and 206(2) of the Advisers Act do not require that the activity be "in the offer or sale of any securities" or "in connection with the purchase or sale of any security." *SEC v. Lauer*, 2008 WL 4372896, *24 (S.D. Fla. September 24, 2008); Advisers Act Release No. 1092, 6 Fed. Sec. L. Rep. (CCH) ¶ 56,156E, at 44,057-7 to 44,058 (Oct. 8, 1987). *See generally*, the Commission's Memorandum of Law in Support of Motion for Ex Parte Temporary Restraining Order, Preliminary Injunction and Other Emergency Relief (which the Commission incorporates herein) at 26-29.

[9] The SEC is not required to allege that investors relied on the misrepresentations, or prove reliance or injury in enforcement actions. *Geman v. SEC*, 334 F.3d 1183, 1191 (10th Cir. 2003); *SEC v. Hopper*, 2006 WL 778640, at *9 n. 15 (S.D. Tex. Mar. 24, 2006).

372, 389-90 (5th Cir. 2007). Deception includes "breach of some duty of candid disclosure," *Credit Suisse*, 482 F.3d at 389, and includes conduct associated with "misstatements, omissions by one who has a duty to disclose, and manipulative trading practices." *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S.Ct. 761, 769 (2008).

Section 206 of the Advisers Act establishes federal fiduciary standards to govern the conduct of investment advisers. *Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 17 (1979). The fiduciary duties of investment advisers to their clients include the duty to act for the benefit of their clients, the duty to exercise the utmost good faith in dealing with clients, the duty to disclose all material facts, and the duty to employ reasonable care to avoid misleading clients. *SEC v. Capital Gains Research Bureau, Inc. et al.*, 375 U.S. 180, 194 (1963). An adviser has "an affirmative obligation to employ reasonable care to avoid misleading [his or her] clients." *Id*.

Violations of Section 17(a)(1) of the Securities Act, Section 10(b) and Rule 10b-5 of the Exchange Act and Section 206(1) of the Advisers Act require scienter. *Aaron v. SEC*, 446 U.S. 680, 701 (1980).[10] Scienter is the "mental state embracing intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 (1976). Scienter may be established by showing intentional or severely reckless conduct. *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929 (5th Cir.), *cert. denied*, 454 U.S. 965 (1981); *Kornman*, 391 F.Supp.2d 477 at 493; *Reynolds* at *2. Severe recklessness is defined as (1) an extreme departure from the standards of ordinary care or (2) a present danger of misleading buyers or sellers of securities that is either

[10] There is no scienter requirement for Securities Act Sections 17(a)(2) and (3) or Section 206(2) of the Investment Advisers Act. *Aaron*, 446 U.S. at 701-02 (1980); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979). A showing of mere negligence suffices. *Id.* Thus, even if the SEC had failed adequately to allege *scienter*, which it has not, the 17(a)(2) and (3) and 206(2) claims would survive defendant's motion to dismiss.

known to the defendant or is so obvious that the defendant must have been aware of it. *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 361 (5th Cir. 2004); *Shushany v. Allwaste, Inc.*, 992 F.2d 517, 521 (5th Cir. 1993); *Broad*, 642 F.2d at 961-62. Under Rule 9(b), scienter "may be averred generally." Fed.R.Civ.P. 9(b); *SEC v. Berry*, 2008 WL 2002537, *10 (N.D. Cal. May 7, 2008)(evaluating the heightened pleading standards of the PSLRA and concluding that, unlike private plaintiffs, "the SEC may allege scienter generally.").[11]

Rule 9(b), which requires allegations of fraud to be pleaded with particularity, is intended to "facilitate a defendant's ability to respond to and prepare a defense to charges of fraud." *SEC v. Sharp Capital, Inc.*, 1999 U.S. Dist. LEXIS 5837 (N.D. Tex. 1999) (citing *Guidry v. Bank of LaPlace*, 740 F. Supp. 1208, 1216 (E.D. La. 1990), *aff'd*, 954 F.2d 278 (5th Cir. 1992)). What constitutes particularity will necessarily differ with the facts of each case. *Benchmark Elec. v. J.M. Huber Corp.*, 343 F.3d 719, 724 (5th Cir. 2003); *modified on other grounds*, 355 F.3d 356 (5th Cir. 2003); *see also Williams v. WMX Techs., Inc.*, 112 F.3d 175, 178 (5th Cir.1997). In the Fifth Circuit, the Rule 9(b) standard requires "specificity as to the statements (or omissions) considered to be fraudulent, the speaker, when and why the statements were made, and an explanation of why they were fraudulent." *Plotkin v. IP Axess, Inc.*, 407 F.3d 690, 696 (5th Cir.2005); *SEC v. Reynolds*, 2008 WL 3850550, *2 (N.D. Tex. August 19, 2008).

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[11] Notably, this is not a private securities action governed by the PSLRA, which provides additional pleading burdens related to scienter. Under Rule 9(b), scienter "may be averred generally." Fed.R.Civ.P. 9(b); *SEC v. Berry*, 2008 WL 2002537, *10 (N.D. Cal. May 7, 2008)(evaluating the heightened pleading standards of the PSLRA and concluding that, unlike private plaintiffs, "the SEC may allege scienter generally") (relying on *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2507-09 (2007)) Plaintiff is mindful of language in *Reynolds*, suggesting in an SEC case that plaintiffs in the Fifth Circuit must allege "factual background adequate for an inference of fraudulent intent . . . ." 2008 WL 3850550, *7. While the Commission respectfully believes there is no such requirement in enforcement actions, the question is irrelevant in this case, where the Commission's Second Amended Complaint alleges with particularity sufficient facts from which the Court could draw appropriate inferences – in fact strong inferences -- of *scienter* against Stanford. Indeed, in *Reynolds*, the Court noted that alleging facts showing a defendant's motive can be sufficient and, elsewhere in the opinion noted that intent may be averred generally. *Reynolds*, 2008 WL 3850550 at *6-7.

With regard to the Commission's fraud allegations, Rule 9(b) does not require "punctilious pleading detail." *SEC v. Brady*, Civil Action No. 3:05-CV-1416-D, 2006 WL 1310320, at *3 (N.D. Tex. May 12, 2006) (quoting *Steiner v. Southmark Corp.*, 734 F.Supp. 269, 273 (N.D. Tex. 1990)). Rule 9(b) does not require plaintiffs to plead detailed evidence or state all facts relevant to the case. *Sharp*, 1999 WL 242691, at *2 (citing *SEC v. Diversified Indus. Inc.*, 465 F. Supp. 104, 111 (D.D.C. 1979) (stating that the "details of the scheme" were sufficient because they adequately apprised the defendants of the basic transactions and enabled them to prepare a defense)). Rather, Rule 9(b), "read in conjunction with Rule 8, which requires only a short and plain statement of the claim showing that the pleader is entitled to relief," *Brady*, 2006 WL 1310320, at *3, merely requires a plaintiff to plead facts "analogous to the first paragraph of a newspaper story, 'namely the who, what, when, where and how.'" *Id*,(*quoting Melder v. Morris*, 27 F.3d 1097, 1100 n.5 (5th Cir. 1994)).

Here, the Second Amended Complaint details Stanford's specific fraudulent misrepresentations to investors and specific actions he took in furtherance of the fraudulent scheme, including his misappropriation of billions of dollars. These allegations easily meet the standard to survive a motion to dismiss.

2. PROPER ALLEGATIONS

Stanford claims that the Second Amended Complaint does not state what he individually has done that amounts to fraud. [See Memorandum of Law at 7] To make this argument, Stanford is forced to ignore a variety of explicit allegations made against him and to misconstrue others. For example, Stanford conveniently ignores the allegations, among others, that he "approved and/or signed" the 2006 and 2007 Annual Reports that are alleged to have been materially false [See Second Amended Complaint at ¶¶ 35-38]; the allegation that he had misappropriated more than $1.6 billion from SIB and took actions to conceal that theft [See Second Amended Complaint at ¶ 40]; and the allegation that the personal loans to Stanford were inconsistent with representations to investors made in the annual reports signed and/or approved by Stanford [See Second Amended Complaint at ¶ 46].[12] And, not surprisingly, Stanford omits any discussion whatsoever of the detailed allegations that he bribed a foreign "regulator" to hide his fraud.

In any event, the Second Amended Complaint meticulously spells out the "who, what, when, where, and how" of the fraud, and pleads with particularity Stanford's scienter, including both motive and conscious behavior. For example, in addition to the allegations noted above, the Second Amended Complaint alleges that:

- Stanford approved and/or signed SIB's 2006 and 2007 annual reports that represented to investors that SIB's assets were invested in a "well-balanced global portfolio of marketable financial instruments, namely U.S. and international securities and fiduciary placements," specifically "58.6% equity, 18.6% fixed income, 7.2% precious metals and 15.6% alternative investments." These representations were false, and significant portions of the bank's portfolio were misappropriated by Stanford and the largest segments of the portfolio were (i) undocumented "loans" to Stanford, (ii) private equity, and (iii) over-valued real estate. The Second Amended Complaint alleges that, despite having misappropriated significant portions of the bank's portfolio, Stanford approved the making of these false representations [Second Amended Complaint ¶¶ 35-39].

- Stanford approved a 2008 Monthly Report, knowing that the Report falsely represented to investors that SIB had received a capital infusion of $541 million. [Second Amended Complaint ¶¶ 65-66]

- Stanford authorized the use of a brochure provided to investors that falsely claimed that SIB's investment philosophy is "anchored in time-proven conservative criteria" when, in fact, SIB loaned Stanford at least $1.6 billion." [Second Amended Complaint ¶¶34, 38-40];

[12] Stanford does acknowledge the allegation that he took out loans, but then curiously states that the Complaint does not allege specifically the illegality of the loans. As noted above, the Second Amended Complaint alleges quite explicitly that the loans were inconsistent with specific public statements made to investors about SIB's assets. The details regarding those public statements are also explicitly alleged. The same defect applies to Stanford's critique that the Commission has not alleged each date that Stanford directed the fabrication of SIB's financial statements and inflation of its investment returns.

- On January 10, 2009, Stanford represented to SIB's Top Performer's Club in Miami, Florida that "SIB was secure and built on a strong foundation, and that its capital condition was shored up by capital infusions" and failed to disclose that he had invested SIB's funds in a manner inconsistent with offering documents and its own financial statements and that the November 28, 2008 capital infusion was a fiction. He made these misrepresentations, knowing that the advisers would use those representations in selling the CD. [Second Amended Complaint ¶¶ 72-78].

These allegations make clear who lied to investors (i.e., Stanford), what he lied about (i.e., specifically misrepresenting the liquidity and nature of the bank's investment portfolio and the supposed receipt of capital contributions), when, where, and how the lies were told (i.e., in SIB's 2006 and 2007 annual reports, the 2008 Monthly Report, and on June 10, 2009 in Miami). *See, e.g., SEC v. Sys. Software Assocs*., 145 F. Supp. 2d 954, 957-58 (N.D. Ill. 2001) (denying motion to dismiss, noting that the complaint identified revenue statements with false information signed by the defendant).

The allegations also specify how the representations were false (for example, rather than liquid investments as promised, the bank's investment portfolio was comprised primarily of "loans" to Stanford and overpriced real estate, and there was no true capital infusion as touted). Finally, the Second Amended Complaint describes specifically why Stanford committed this fraud, namely to misappropriate billions of dollars in investor funds and, in some instances, trick investors into not catching onto the fraud. [*See, e.g.*, Second Amended Complaint ¶¶ 1, 57-58].

Likewise, the Second Amended Complaint details exactly which role Stanford played in the fraudulent scheme. For example, the Commission alleges: Stanford concealed his theft of at least $1.6 billion by signing putative personal "loans" and that these "loans" were inconsistent with public statements Stanford signed and/or approved regarding SIB's assets [Second Amended Complaint at ¶ 40, ¶¶ 46-47]; Stanford directed the falsification of investment returns that were included in SIB's annual reports and website that were made available to investors

[Second Amended Complaint at ¶¶ 51-55]; that Stanford bribed Leroy King in order to help hide the fraud and, as a result of these bribes, actually drafted responses to Commission inquires that were putatively from the FSRC. [Second Amended Complaint at ¶¶84-93]; and that Stanford provided materially false information to investment advisers knowing that this false information would be used to sell the CD [Second Amended Complaint at ¶¶ 72-78]. It is precisely these types of detailed allegations that are sufficient to state a claim. *See, e.g.*, *SEC v. Homa*, 2000 U.S. Dist. LEXIS 11156, at **9, 10, 13 (N.D. Ill. 2000) (holding that complaint clearly specified "which defendants committed fraud on investors as part of the Ponzi scheme" and "details the roles these defendants played in the fraud").[13]

In addition to detailing Stanford's fraudulent conduct, the Second Amended Complaint sets out facts clearly demonstrating his *scienter*. Not only does it generally allege that Stanford acted with the requisite mental state, the Second Amended Complaint alleges explicitly, including the time and place, that Stanford admitted to misappropriating investor funds and fabricating the bank's financial statement. [Second Amended Complaint ¶ 56] The Second Amended Complaint further alleges, for example, that Stanford fabricated the performance of the bank's investment portfolio by providing to SIB's internal accountants a pre-determined return on investment that was then used to reverse-engineer the banks' financial statements. [Second Amended Complaint ¶¶ 53-54] Finally, the Second Amended Complaint alleges that Stanford bribed a foreign regulator in order to hide his conduct. It is difficult to imagine stronger

[13] It is of little consequence that Stanford used his financial advisers to disseminate his fraud. *See, e.g.*, *SEC v. Holschuh*, 694 F.2d 130, 134-35 (7th Cir. 1982) (affirming judgment against defendant who made false statement to individual who then drafted documents to be sent to investors).

evidence that Stanford knew he was defrauding investors than the facts alleged throughout the Second Amended Complaint.[14]

Finally, Stanford argues that the Commission has failed to allege he was acting as an investment adviser. The definition of an investment adviser in Section 202(a)(11) of the Advisers Act, 15 U.S.C. § 80b-2(a)(11), includes "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." The Second Amended Complaint alleges explicitly that Stanford approved the issuance of publications designed to advise investors as to the value of and the advisability of investing in SIB's CD and that he received compensation related to that advice. Moreover, the Second Amended Complaint alleges that Stanford controlled SGC and its investment advisors, who routinely advised investors. Through that control, Stanford satisfies the statutory definition of an investment adviser. *See, e.g., SEC v. Berger*, 2001 U.S. Dist. LEXIS 18448, at *28 (S.D.N.Y. Nov. 13, 2001) (finding associated person liable under §§ 206(1) and (2) based on control of investment adviser), *aff'd on other grounds*, 2003 U.S. App. LEXIS 3562 (2d Cir. Feb. 27, 2003); *SEC v. Gotchy*, 981 F.2d 1251 (4th Cir. 1992) (unpublished table decision) (finding president and half-owner of investment adviser liable under §§ 206(1) and (2)); *In re Jay Deforest Moore, et al.*, Investment Advisers Act Rel. No 1548 (Jan. 19, 1996), 61 SEC Docket 544, 545 (charging individual with direct violations of Sections 206(1) and (2) of the Advisers Act because he "exercised exclusive control over" the firm and, therefore, was the firm's alter ego).

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[14] When a defendant fabricates information he knows will be used to prepare financial reports, he may be held liable for violating the antifraud provisions. *See e.g., In re Suprema Specialities, Inc. SEC. Litig.*, 438 F.3d 256 (3rd Cir. 2006).

In sum, the Second Amended Complaint states a claim against Stanford and his motion to dismiss should be denied. *See, e.g., In re First Acceptance Corp. Sec. Litig.*, 1998 U.S. Dist. LEXIS 17760 at *27-28 (N.D. Ill. 1998) (recognizing that the complaint contains enough details to ensure that the case was not a "fishing expedition" or "smear campaign.")

C. VENUE IS PROPER IN THE NORTHERN DISTRICT.

The SEC's complaint alleges that this Court has jurisdiction over this matter pursuant to Section 22(a) of the Securities Act of 1933, [15 U.S.C. § 77v(a)], and Sections 21(e) and 27 of the Securities Exchange Act of 1934 (Exchange Act), [15 U.S.C. §§ 78u(e) and 78aa]. [Second Amended Complaint. ¶ 11] Section 27 of the Exchange Act is a special venue provision that makes venue appropriate in an SEC civil enforcement action in any district where an "act or transaction constituting the violation occurred" or in the district "wherein the defendant is found or is an inhabitant or transacts business." 15 U.S.C. § 78aa; *see also SEC v. Ernst & Young*, 775 F. Supp. 411, 412 (D.D.C. 1991); *Investors Funding Corp. v. Jones*, 495 F.2d 1000, 1002-03 (D.C. Cir. 1974).

The Second Amended Complaint explicitly alleges that certain of the transactions, acts, practices and courses of business occurred in the Northern District of Texas. [Second Amended Complaint at ¶12] It further alleges that SGC has 29 offices located throughout the United States [Second Amended Complaint at 14] and it is undisputed that SGC had an office in Dallas, a fact wholly-ignored by Stanford. [See TRO App. 0945, listing SGC U.S. offices, including Dallas].[15] Moreover, it cannot be disputed that certain victims of Stanford's fraud reside in the Northern District. Finally, the Second Amended Complaint is replete with allegations concerning various acts in furtherance of the fraud involving false communications with Commission staff, who

[15] A district court may examine facts outside the complaint to determine whether its venue is proper. *See generally* WRIGHT & MILLER FEDERAL PRACTICE AND PROCEDURE CIVIL 3d §1352.

were located in the Northern District of Texas. [See, e.g., Second Amended Complaint at ¶¶ 87, 88, 90, 91, 92]. In short, while numerous districts may have presented a proper venue, there is no doubt that the Northern District is also proper. There is no basis to dismiss the Second Amended Complaint based on improper venue.

Finally, it is worth noting that Stanford has participated vigorously in the enforcement action in the Northern District and the associated receivership. He has made countless appearances, including a prior motion to dismiss that did not challenge venue, and has appealed this Court's orders without complaining as to venue. *Cf. American Patriot Ins. Agency v. Mutual Risk Mgmt., Ltd.*, 364 F.3d 884, 888 (7th Cir. 2004) (noting that if the defendant misleads the court into becoming involved in the case so that there would be wasted judicial effort were the case to be dismissed to another forum, or if he stalls in pleading improper venue because he wants to find out which way the wind is blowing, then conventional principles of waiver or equitable estoppel come into play and if invoked by the plaintiff block the challenge to venue). The significant activity in this case further demonstrates that Stanford's venue challenge should be rejected.

D. SUMMARY

For the reasons outlined above, Stanford's motion to dismiss should be denied. If, however, the Court concludes that the Second Amended Complaint is deficient in some manner, the Commission respectfully requests that the Court grant the Commission leave to amend its pleading. Stanford's motion relates to what are, at worst, curable pleading deficiencies, not irreparable flaws. Leave to amend a deficient pleading should be "freely given," absent any apparent or declared reason – such as, for example, undue delay, bad faith or dilatory motive by the pleading party, repeated failure to cure deficiencies by amendments previously allowed, or undue prejudice to the opposing party. *Forman v. Davis,* 371 U.S. 178, 182 (1962). Here, there is no basis to find undue delay, prejudice or bad faith. Accordingly, if the Court determines that the Second Amended Complaint requires clarification, it should instead grant the Commission the opportunity to replead its claims to address any shortcomings. Likewise, if the Court has any concerns regarding its subject matter over this litigation, the Commission submits it would be more appropriate to allow further pleading or other proceedings to further demonstrate the Court's jurisdiction.

III.
CONCLUSION

For the reasons set out above, the Commission respectfully submits that the motion to dismiss should be dismissed and that the Court issue such further relief deemed just and proper.

Dated March 11, 2010

Respectfully submitted,

s/ David B. Reece

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CERTIFICATE OF SERVICE

I hereby certify that on March 11, 2010, I electronically filed the foregoing document with the Clerk of the court for the Northern District of Texas, Dallas Division, by using the CM/ECF system which will send notification of such filing to all CM/ECF participants and counsel of record.

s/ David B. Reece__________