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

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. STANFORD INTERNATIONAL BANK, LTD., STANFORD GROUP CO., STANFORD CAPITAL MANAGEMENT, LLC, R. ALLEN STANFORD, JAMES M. DAVIS, LAURA PENDERGEST-HOLT, GILBERTO LOPEZ, MARK KUHRT, and LEROY KING, Defendants, and STANFORD FINANCIAL GROUP CO. and THE STANFORD FINANCIAL GROUP BUILDING INC., Relief Defendants.	§	Case No.: 3-09-CV-0298-N

DEFENDANT R. ALLEN STANFORD'S REPLY IN SUPPORT OF HIS MOTION TO DISMISS PLAINTIFF'S SECOND AMENDED COMPLAINT

This Court must decide Defendant R. Allen Stanford's Motion to Dismiss based on the Second Amended Complaint ("Complaint") itself, and not on a complaint that the Securities and Exchange Commission might have pleaded. In the last thirteen months, the SEC has tried three times to properly plead its Complaint. Even after three attempts, however, the Complaint still contains at least three dispositive defects.

First, the Complaint fails to adequately plead allegations that show this Court has jurisdiction over Mr. Stanford. The SEC's Response ignores critical facts in this case, and the weight of Supreme Court authority—including the SEC's own cited cases—shows that the certificates of

deposit ("CDs") in question are not securities within SEC or this Court's jurisdiction. Second, the SEC has failed to describe the "who, what, when, why, where and how"-related details that Federal Rule of Civil Procedure 9(b) and the Fifth Circuit explicitly require. Third and finally, the SEC has failed to demonstrate that venue lies properly in this District over Mr. Stanford. Although the SEC has not alleged an alter ego theory of liability, it attempts improperly to establish venue over Mr. Stanford through the alleged actions of other defendants.

Given these defects, Mr. Stanford respectfully urges this Court to deny the SEC's newest request for permission to amend, and to instead dismiss the Complaint with prejudice.

I. THE SEC HAS FAILED TO ESTABLISH THAT STANFORD INTERNATIONAL BANK, LTD. ("SIB") CERTIFICATES OF DEPOSIT ARE SECURITIES WITHIN THIS COURT'S JURISDICTION

The SEC, in its Response, was unable to contravene the authority of the United States Supreme Court that "[t]here is an important difference between a bank certificate of deposit and other long-term debt obligations," because a CD is generally "issued by a federally regulated bank which is subject to the comprehensive set of regulations governing the banking industry." *Marine Bank v. Weaver*, 455 U.S. 551, 557 (1982). The SEC also fails to refute Supreme Court authority that, "[i]t is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws . . . ." *Id.* at 559.

Instead of dealing with this problem directly, the SEC attempts to distract, arguing incorrectly that the Supreme Court's ruling in *Marine Bank* was superseded by *Reves v. Ernst & Young*, 494 U.S. 56, 64 (1990). According to the SEC, *Reves* declares that "all notes—including products such as 'the certificates of deposits' . . . are presumed to be securities." *See* Resp. Br. at 4, 8 n.7. But *Reves* says no such thing, and instead merely states that, while the presumption is that a security includes "any note" because the Exchange Act uses the term "note," that presumption is rebuttable by a long list of factors, contexts and types of notes, including that "only notes with a term of more

than nine months are . . . 'securities.'" *Id.* at 65 n.3. These strict limitations are in place because "Congress did not . . . intend to provide a broad federal remedy for all fraud." *Id.* at 61 (internal quotation marks omitted). Further, nowhere in the decision does *Reves* say that a CD is presumed to be a "security"—indeed, *Reves*'s only reference to a CD as a security is to distinguish the notes in *Reves*, which were uninsured and uncollateralized (a factor that weighed in favor of their status as "securities"), from the CDs in *Marine Bank*, which were held not to be "securities" because they were insured by the Federal Deposit Insurance Corporation. *See Reves*, 494 U.S. at 69.

As in *Marine Bank*, and as distinguished from the notes in *Reves*, the CDs here are subject to substantial regulation under Antiguan law, and have no need of additional regulation by the SEC. *See* 2d Am. Compl. ¶ 84 (admitting that the "[Financial Services Regulatory Commission ("FSRC")] . . . is charged with the regulation and supervision of all offshore banks licensed in Antigua, including SIB," and acknowledging that the FSRC conducted investigations into SIB, and found it to be compliant with Antiguan regulations). Moreover, as the SEC begrudgingly acknowledges, *see* Resp. Br. at 7 n.4, over-generalized claims that foreign authorities in Antigua were "not enforcing" foreign bank regulations should not be considered in this analysis. *See West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 827 (9th Cir. 1987) ("[T]he scope of our inquiry into the actions of foreign governments is limited by the act of state doctrine. In this case, that doctrine prevents us from scrutinizing the alleged non-feasance or misfeasance of the Mexican officials charged with enforcing their country's banking laws.").

The SEC also argues that the question of whether these CDs are securities is controlled by the four-factor "family resemblance" test in *Reves*. Even assuming *arguendo* the test applies here, the Complaint is still devoid of sufficient allegations to satisfy that test. For example, mere speculation by the SEC about what buyers may have considered in purchasing SIB's CDs is certainly not enough; it is notable that the Complaint includes no facts pertaining to what investors actually

perceived (much less what they reasonably expected), for example.[1] There is no dispute that the SIB products were publicly marketed and sold as "certificates of deposit"; the public reasonably believed these products to be CDs, and the SEC does not address why investors would have ignored this fact. The SEC also claims that the Court should discount the fact that these CDs were regulated by Antiguan regulatory authorities because Leroy King, Chief Executive Officer of the FSRC, allegedly aided and abetted violations of U.S. law, such that Antigua could not have properly supervised SIB. *See* 2d Am. Compl., Counts II, V. The SEC does not describe how Mr. King singlehandedly circumvented or suppressed the entire Antiguan banking oversight system, however, such that Antigua's regulation and investigations of SIB's CDs was entirely ineffective.

In addition, the SEC claims that these CDs are securities because SIB filed Forms D in conjunction with the private placement sale of the CDs. *See* Resp. Br. at 6. The SEC has provided no legal authority to show that the mere filing of a Form D is dispositive of the question of whether the CDs are securities. Moreover, the Forms cannot be dispositive here because the SEC did not attach them to any version of its Complaint, such that those documents are not properly before the Court on this Motion.

Finally, the SEC claims that SIB "lured U.S. investors to sell stocks, bonds and other securities they owned in order to invest the proceeds in SIB's CD[.]" Resp. Br. at 10 n.2. It is no more relevant that SIB's clients sold "stocks, bonds and other securities" than if they moved money from a traditional savings account into SIB's CDs. Further, the SEC relies for its argument on *SEC v. Zandford*, 535 U.S. 813, 825 (2002), but *Zandford* does not state that the SEC has jurisdiction over any transaction undertaken by an investor using the proceeds of a sale of securities. Instead,

[1] The Court must resolve this motion to dismiss without reaching to facts outside the Complaint. *See, e.g., Whiddon v. Chase Home Finance, LLC*, 666 F.Supp.2d 681, 686 (E.D. Tex. 2009). Therefore, the SEC's prejudicial reference to Mr. Stanford's invocation of his Fifth Amendment rights, *see* Resp. Br. at 10 n.2, is not properly before this Court on the Motion, and certainly cannot be used to imply that Mr. Stanford believes SIB "lured" consumers to purchase products.

Zandford simply held that a broker's alleged conduct of selling clients' securities with undisclosed intent to misappropriate the proceeds constituted fraud "in connection with the purchase or sale of any security." *Id.* at 813-17.

II. THE COMPLAINT FAILS TO SATISFY RULE 9(B): THE SEC NEVER ALLEGES MR. STANFORD IS AN INVESTMENT ADVISOR, AND FAILS TO ALLEGE THE SPECIFIC DETAIL REQUIRED IN THIS CIRCUIT FOR ITS OTHER CLAIMS

A. The SEC Has Not Adequately Alleged Mr. Stanford Is An Investment Adviser as Required for Liability Under the Investment Advisers Act

The SEC argues it has properly alleged that Mr. Stanford is an "investment adviser" because, first, the Complaint alleges that Mr. Stanford approved publications used to advise individuals to invest in SIB's CDs and that he received compensation for that advice and, second, because Mr. Stanford exercised control over Stanford Group Co. ("SGC") and its advisers. Both arguments fail.

The Investment Advisers Act ("IAA") defines an investment adviser as "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." 15 U.S.C. § 80b-2(a)(11). Although the Complaint arguably alleges SGC engaged in the business of advising others as to SIB's CDs, and states generally that SGC is a wholly owned subsidiary of Stanford Group Holdings, Inc. ("SGH"), which, in turn, is owned by Mr. Stanford, it does not allege Mr. Stanford's role in SGC other than. 2d Am. Compl. ¶ 14. The SEC's allegations that Mr. Stanford approved 2006 and 2007 annual financial reports and one monthly statement in 2008 for SIB—a totally separate corporate entity from SGC—do not make Mr. Stanford in the business of advising others. If that were the case, any corporation that is publicly traded and issues regular financial statements would be considered an "investment adviser."

In addition, contrary to the SEC's assertion, Resp. Br. at 16, the Complaint does not allege that Mr. Stanford received compensation related to advising others as to SIB's CDs. The Complaint

alleges that SIB paid commissions to SGC and its advisers for selling the SIB CDs. 2d Am. Compl. ¶ 28. The Complaint does not allege, however, that SGC's corporate form should be disregarded and those commissions imputed to Mr. Stanford for purposes of IAA liability.

The SEC similarly cannot rely on a conclusory allegation of Mr. Stanford's "control" over SGC, 2d Am. Compl ¶ 1, to establish that Mr. Stanford is an investment adviser. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) ("[T]he tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions."). Under basic agency principles, "a corporation does not become the agent of another corporation merely because the other has stock control." Restatement (Second) of Agency §14M, cmt. a. The SEC has omitted any allegations describing how Mr. Stanford's ownership of SGH makes SGC the agent of SGH, or—even more attenuated—that SGC is Mr. Stanford's agent. *See Meyer v. Holley*, 537 U.S. 280, 286 (2003) ("[I]t is the corporation, not its owner or officer, who is the principal or employer, and thus subject to vicarious liability for torts committed by its employees or agents."). The Complaint does not allege that Mr. Stanford and these other entities are alter egos of one another.

The SEC relies upon a single district court case, from outside the Fifth Circuit, to support its assertion that merely alleging "control" is sufficient to establish Mr. Stanford is an investment advisor. That case, *United States v. Berger*, 244 F. Supp. 2d 180 (S.D.N.Y. 2001), is entirely distinguishable, in any event, because the Court found that "Berger owns and controls MCM and is the company's only officer. MCM has no directors, and Berger was solely responsible for overseeing MCM's day-to-day operations in New York and supervising its six employees. . . . . In sum, MCM [was] a one-man show, with Berger making all substantive investment decisions." *Id.* at 185. Here, the SEC has not alleged Mr. Stanford's role at SGC, nor that he was responsible for overseeing day-to-day operations.

Moreover, not only is *Berger* not binding, but also it provides neither analysis nor authority as to why Mr. Berger's control of MCM rendered him an investment adviser. *See In re Pratt*, 524 F.3d 580, 588 (5th Cir. 2008) (finding Seventh Circuit decision unpersuasive because it provided little analysis and cited no authority for its holding). A more careful analysis by the *Berger* court may have revealed that, aside from agency theory, "control" liability under the IAA is only available under Section 208, which is not the basis for the SEC's claims in this case. 15 U.S.C. § 80b-8(d). Indeed, another case from the Southern District of New York, from which *Berger* was issued, makes clear that because the SEC has not established "by more than conclusory allegations that defendant was an investment adviser," the IAA claim must be dismissed. *Kassover v. UBS AG*, 619 F. Supp. 2d 28, 33 (S.D.N.Y. 2008).

B. The SEC Fails to Allege the Required Detail For Its Remaining Claims Against Mr. Stanford

Despite the SEC's protestations that it need not do so, the Fifth Circuit does plainly "interpret[] Rule 9(b) strictly," and does "requir[e] the plaintiff to specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 207 (5th Cir. 2009) (internal quotation marks omitted). The Complaint is critically lacking the specific facts required by this Court and Rule 9(b). For example, one of the SEC's key allegations is that Mr. Stanford falsified SIB's financial statements. *See, e.g.*, 2d Am. Compl. ¶¶ 48-54. The Complaint alleges simply that "Stanford and Davis typically provided to SIB's internal accountants, including Lopez and Kuhrt, a predetermined return on investment for the bank's portfolio. Using this predetermined return, SIB's accountants, including Lopez and Kuhrt, reverse-engineered the bank's financial statements." *Id.* ¶ 53. There are no specifics about what the "pre-determined return" was; how Mr. Stanford created those "pre-determined returns"; how the pre-determined returns were fraudulent; when or where or how Mr. Stanford provided those pre-

determined returns" to the accountants; or, when or how or even that Mr. Stanford instructed SIB's internal accountants to use the "pre-determined return" to falsify the bank's financial statements.

Similarly, the SEC also relies heavily on the allegation that Mr. Stanford, along with other of the defendants, "approved and/or signed" certain documents as the basis for its fraud claims. *See, e.g.*, *id.* ¶¶ 38, 59. But the SEC does not allege when or how Mr. Stanford approved those documents; what the nature of that approval entailed and whether he actually reviewed the documents before he purportedly approved them; or how that approval process actually worked, such as to whom he communicated his approval. This Court cannot take these conclusory allegations about Mr. Stanford's fraudulent conduct as true, and must instead dismiss the Complaint. *See, e.g.*, *Fin. Acquisition Partners LP v. Blackwell*, 440 F.3d 278, 287 (5th Cir. 2006) (holding that a district court must dismiss a securities-fraud claim failing to satisfy Rule 9(b)'s pleading requirements, and that a "plaintiff must plead specific facts, not conclusory allegations, to avoid dismissal")); *Rios v. City of Del Rio, Texas*, 444 F.3d 417, 421 (5th Cir. 2006) (same).

These few examples are truly indicative of the entire Complaint. After three attempts, the Complaint still lacks the necessary dates, names, locations, and references to Mr. Stanford's specific conduct required under Rule 9(b). The Complaint must accordingly be dismissed with prejudice.

III. THE SEC HAS NOT MET ITS BURDEN TO SHOW VENUE IS PROPER

Even under the special venue provision of the Exchange Act, 15 U.S.C. § 78aa, the SEC has not met its burden of demonstrating venue is proper over Mr. Stanford in this District. "Once a defendant has objected to a plaintiff's chosen venue, as defendants have done, the burden shifts to the plaintiff to establish that venue is proper." *TGI Friday's Inc. v. Great Nw. Rests., Inc.*, 652 F. Supp. 2d 750, 758 (N.D. Tex. 2009) (Fitzwater, C.J.).

"[I]t is well established that in a case involving multiple defendants and multiple claims, the plaintiff bears the burden of showing that venue is appropriate as to each claim and as to each

defendant." *See, e.g.*, *McCaskey v. Continental Airlines, Inc.*, 133 F. Supp. 2d 514, 523 (S.D. Tex. 2001) (emphasis added) (internal quotation marks omitted). The SEC's claims about proper venue only focus on SGC, and do not address why venue is proper as to Mr. Stanford himself. *See* Resp. Br., at 17-18. The SEC must establish Mr. Stanford's own connection with this District, for example, that Mr. Stanford himself performed an "act or transaction constituting the [Exchange Act] violation" or "transact[ed] business" in that Dallas office. 15 U.S.C. § 78aa. While SGC's Dallas office may subject SGC to venue in the Northern District—an allegation that the SEC leaves out of the Complaint—even that fact falls short of establishing venue is proper over Mr. Stanford.

The SEC also alleges for the first time in its Response, but nowhere in the Complaint, that "victims of Stanford's fraud reside in the Northern District." Resp. Br. at 17. Although the SEC could have supplied evidence to the Court in its briefing about these victims, *see Ambraco, Inc. v. Bossclip B.V.*, 570 F.3d 233, 238 (5th Cir. 2009), it did not so do. Moreover, decisions from this District make plain that, simply because "a plaintiff feels the effects of defendant's conduct in a certain district does not mean that the events or omissions [giving rise to the claim] necessarily occurred in that district." *Inst. for Creation Research Graduate Sch. v. Paredes*, Civ. A. No. 3:09-CV-0693-B, 2009 WL 4333366, at *3 (N.D. Tex. Dec. 1, 2009).

The SEC next claims that Mr. King's allegedly false communications to the SEC "in furtherance of the fraud" establish venue. Resp. Br. at 17-18. But, an act "in furtherance of" the purported violation is insufficient—the special venue provision upon which the SEC relies to establish venue states that only an "act or transaction constituting the [Exchange Act] violation" can serve as the basis of venue. 15 U.S.C. § 78aa. Further, the SEC's arguments about Mr. King's actions and his connection to the SEC's Dallas office are not sufficient to show venue is proper over Mr. Stanford. *See, e.g.*, *McCaskey*, 133 F. Supp. 2d at 523.

Finally, Mr. Stanford has not waived venue by defending himself in this case. He objected to venue in his Answer to the First Amended Complaint, and timely objects to venue again with this Motion. *See Transfigura Beheer B.V. v. M/T PROBO ELK*, 266 Fed. Appx. 309, 312 (5th Cir. 2007) (holding that defendant does not waive venue by raising it in an answer rather than a motion to dismiss).

IV. THE SEC HAS HAD ENOUGH TIME AND MADE ENOUGH ATTEMPTS; THIS CASE SHOULD BE DISMISSED WITH PREJUDCE

The Court should not permit the SEC yet a fourth attempt to re-plead its Complaint in order "to cure deficiencies by amendments previously allowed," *see Forman v. Davis*, 371 U.S. 178, 182 (1962), and instead should dismiss the Complaint with prejudice. *See Goldstein v. MCI WorldCom*, 340 F.3d 238, 255 (5th Cir. 2003) (upholding district court's denial of leave to amend where, "almost as an afterthought, the plaintiffs tacked on a general curative amendment request to the end of their response in opposition to the defendants' motion to dismiss"); *Matter of Southmark Corp.*, 88 F.3d 311, 315-16 (5th Cir. 1996) (affirming district court's refusal to grant leave to amend when the underlying facts were known at the time the original and amended complaints were filed). The SEC has provided no justification for why this additional, and costly, delay should be permitted. For these and the foregoing reasons, Mr. Stanford respectfully avers that the Complaint should be dismissed with prejudice.

Dated: March 29, 2010

Respectfully submitted,

/s/ Shannon W. Conway

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CERTIFICATE OF SERVICE

I hereby certify that this document filed through the ECF system will be sent electronically to the registered participants as identified on the Notice of Electronic Filing and paper copies will be sent those indicated as non-registered participants on March 29, 2010.

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