No. 09-10761

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

RALPH S. JANVEY,

Plaintiff - Appellant-Cross-Appellee

v.

GAINES D. ADAMS; NEN FAMILY TRUST; JEFF P. PURPERA, JR; CHERAY ZAUDERER HODGES; LUTHER HARTWELL HODGES; ET AL 1; JOSEPH BECKER, TERRY BEVEN; KENNETH BIRD; JAMES BROWN; MURPHY BUELL; ET AL 2; JAMES RONALD LAWSON; DIVO MILAN HADDAD; SINGAPORE PUNTAMITA PTE., LTD; NUMA L. MARQUETTE; GAIL G. MARQUETTE,

Defendants - Appellees-Cross-Appellants

JAMES R. ALGUIRE; VICTORIA ANCTIL; SYLVIA AQUINO; JONATHAN BARRACK; NORMAN BLAKE; ET AL; TIFFANY ANGELLE; MARIE BAUTISTA; TERAL BENNETT; SUSANA CISNEROS; RON CLAYTON; ET AL 3; HANK MILLS; ROBERTO ULLOA; JAY STUART BELL; GREGORY ALAN MADDUX; DAVID JONATHAN DREW; ANDRUW RUDOLF BERNARDO JONES; CARLOS FELIPE PENA; JOHNNY DAVID DAMON; BERNABE WILLIAMS; PATRICIA A. THOMAS, in her capacity as independent executor of the estate of Christopher Allred; PATRICIA A. THOMAS; ROLAND SAM TORN; PAULA MARLIN,

Defendants - Appellees

Consolidated with
09-10765

RALPH S. JANVEY, in His Capacity as Court-Appointed Receiver,

Plaintiff - Appellant

v.

JIM LETSOS; FELIPE GONZALEZ; CHARLOTTE HUNTON; RICHARD O. HUNTON; CHARLES HUNTON,

Defendants - Appellees

On Appeal from the United States District Court for the Northern District of Texas, Dallas Division C.A. 3:09-CV-0724-N

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN SUPPORT OF APPELLEES

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is the agency principally responsible for the enforcement of the federal securities laws and the protection of the investing public. *See* Sections 19 and 20 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77s, 77t; Section 21 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78u. These appeals (Nos. 09-10761 and 09-10765) have been taken from orders entered in actions brought by the receiver appointed at the Commission's request in the Commission's enforcement action against R. Allen Stanford and his companies involving a massive Ponzi scheme.

In the cases brought by the receiver, he is suing hundreds of innocent fraud victims who invested in certificates of deposit ("CDs") issued by Stanford International Bank ("SIB"). The receiver seeks to recover payments of CD principal and interest that SIB made to these investors ("Investor Defendants") prior to the receivership, commonly referred to as "claw-back" claims. The Commission argued in the district court that on the facts of this case it would be inequitable and improper for the receiver to maintain these claims.

On motion by the receiver for an order freezing the brokerage accounts of the Investor Defendants in an amount equal to the payments received from SIB, the district court granted the freeze in part – with respect to purported CD *interest* payments received by the Investor Defendants – but denied the freeze with respect to purported CD *principal* payments. The court, agreeing with the Commission, found that "innocent investors in this case who redeemed their investments before the Receivership are not liable for return of principal, and therefore, the Receiver has failed to establish that he is likely to prevail on the merits of his claims with regard to CD principal redemption payments." Nonetheless, the court froze the accounts to the extent of the value of purported CD principal and interest payments for ten days to allow the receiver to seek appellate relief.

The receiver appealed to this Court from the partial denial of the freeze. The Court granted the receiver's motion for a stay pending appeal freezing the accounts in an amount equal to the principal repayments.

The receiver argues before this Court that he has viable claw-back claims against the Investor Defendants. The Commission submits this *amicus curiae* brief, pursuant to Fed. R. App. P. 29(a), to address the question raised by the receiver's appeals: Whether the receiver may obtain disgorgement of principal repayments made to the Investor Defendants.[1/]

1/ The term "principal payments" refers to funds received by innocent investors up to the amount of funds invested. Likewise, the term "interest payments" in the context of this case refers to funds received by innocent investors beyond the amount of funds invested.

FACTS

The Commission instituted a civil enforcement action against Stanford and his companies on February 16, 2009 (Supp. R. 3),[2/] and filed an amended complaint on February 27, 2009 (Supp. R. 96). The Commission alleged a massive Ponzi scheme in the sale of SIB CDs, naming R. Allen Stanford, James M. Davis, and SIB, among others, as defendants (Supp. R. 96 ¶1). By the end of 2008, SIB had sold more than $7.2 billion of CDs by touting SIB's safety and security, consistent double-digit returns on its investment portfolio, and high rates of return on the CDs that greatly exceeded rates offered by U.S. commercial banks (Supp. R. 97 ¶3). Stanford and Davis, however, misappropriated billions of dollars of investor funds and invested the money in speculative, unprofitable private businesses controlled by Stanford (*id.* ¶4). In an effort to conceal their fraudulent conduct, Stanford and Davis fabricated the performance of SIB's investment portfolio and lied to investors about the nature and performance of the portfolio (*id.* ¶5). Rather than making principal redemptions and interest payments from earnings, purported interest and principal payments on pre-existing CDs were made out of funds from the sale of other SIB CDs (USCA5 303-04 ¶14).

2/ "Supp. R." refers to the Supplemental Record on Appeal from Civil Action 3:09-CV-298-N. "USCA5" refers to the Original Record on Appeal. "Tr. USCA5" refers to the Transcript of Proceedings.

After filing its initial complaint, the Commission moved the court for an order freezing the defendants' assets and granting other preliminary relief (Supp. R. 29), and appointing a receiver to administer the defendants' assets (Supp. R. 83). The court, in addition to freezing the defendants' assets (Supp. R. 77-78), "restrained and enjoined" all individuals and entities "from disbursing any funds, securities, or other property obtained from Defendants without adequate consideration" (Supp. R. 78). The court also appointed a receiver in order to prevent waste and dissipation of the defendants' assets to the detriment of investors (Supp. R. 85). The receiver interpreted the asset freeze as freezing "the assets of Stanford customer accounts" held at Pershing and JP Morgan (Supp. R. 383), which had contracted with one or more Stanford companies to provide account services for Stanford customers (Supp. R. 307-355). The court's order appointing the receiver authorized him to institute actions and proceedings against third parties in possession of assets traceable to the receivership estate (Supp. R. 88 ¶5(c)).

On April 23, 2009, the receiver informed the court that he was "considering filing . . . claims to 'claw back' proceeds received by a number of customer account holders from redemption of [SIB] CDs, or interest paid on [SIB] CDs" (Supp. R. 818). The receiver noted that he had already "filed claims against former Stanford financial advisers seeking disgorgement of more than $40 million in compensation they received related to the sale of [SIB] CDs" (*id.*). The receiver viewed the claw-back claims against the investors as a similar attempt to recover "substantial amounts of cash" transferred from SIB (*id.*).

The court-appointed examiner, however, whom the court ordered to "convey to the Court such information as the Examiner, in his sole discretion, shall determine would be helpful to the Court in considering the interests of the investors" (Supp. R. 473), expressed "significant reservations as to whether it is appropriate or equitable for the Receiver to pursue 'claw back' claims against a relatively small number of Stanford customers who (i) have done nothing wrong, and (ii) are being targeted for such 'claw back' claims simply because those customers have assets that are frozen" (Supp. R. 1959). The examiner noted that the receiver likely could not "assert 'claw back' claims against CD investors who are foreign nationals, received CD proceeds, and never deposited those proceeds in a U.S. account or financial institution," and that there likely were "hundreds, if not thousands, of" such investors (Supp. R. 1960 n.8). The examiner also noted that the court had previously authorized the release from the asset freeze of thousands of Stanford customer accounts (Supp. R. 1957). The examiner urged the court "to address the Receiver's intentions with respect to the assertion of 'claw back' claims" against these investors because "the prospect that these 'claw back' claims may someday be filed and adjudicated is the sole justification for the continued freeze" of these Stanford customer accounts (Supp. R. 1960-61).

In response to the examiner's report, the court issued an order finding "that the freeze has lasted long enough to permit the Receiver to assess whether he has viable [claw-back] claims against the various individual investors, and that it is time now for those claims to be asserted and tested" (Case No. 09-298 Doc. 533; Supp. R. 001 (order including Doc. 533 in the Supplemental Record)). Accordingly, the court ordered "that its prior orders freezing the accounts of individual investors are vacated to that extent effective noon, August 3, 2009" (*id.*).

Prior to August 3, 2009, the receiver filed "claw-back" actions against fourteen investors in SIB CDs who received proceeds from principal redemption and interest payments on the CDs and whose accounts were frozen by court order, naming these investors as "relief defendants" (USCA5 55-68, 69-80; Case No. 09-1329 Doc. 1). The receiver, however, did not sue under fraudulent transfer law as is typically done when receivers bring such actions in Commission enforcement cases involving Ponzi schemes, *see, e.g., SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295 (5th Cir. 2007); instead, the receiver sought to recover the proceeds from the Investor Defendants "pursuant to the equity powers of" the court (*e.g.*, USCA5 65).

The receiver acknowledged that he did not allege any wrongdoing on the part of these defendants (*e.g.*, USCA5 56 ¶4). Nonetheless, he brought the claims based on his understanding of his obligation to "assemble assets of the Stanford Defendants into a pool from which distributions ultimately will be made to victims of the Stanford Defendants' fraudulent scheme" (*e.g.*, USCA5 56 ¶5). The receiver sought an order that the Investor Defendants were liable to the receivership estate in amounts equal to the proceeds – repayment of principal plus interest – they received from the fraudulent CDs (*e.g.*, USCA5 57 ¶7).

In response to this development, the Commission filed a motion to modify the order appointing the receiver (Supp. R. 2073). The Commission explained that it "simply does not make a practice of suing innocent victims of Ponzi schemes for the return of *principal*, and applies a great deal of discretion and consideration before asserting claims against victims for the return of *interest* payments received by them" (Supp. R. 2075). In this case, the Commission stated, it would not pursue claims against innocent victims absent compelling reasons, and the Commission did not find such compelling reasons in the receiver's motions (Supp. R. 2076). The Commission argued that, as plaintiff, it deserved a high degree of deference in shaping the case and the type of relief sought (Supp. R. 2075-76). It therefore sought an order modifying the receiver's authority so that the Commission had the "exclusive authority to file claims against persons or entities that purchased Stanford International Bank certificates of deposit" (Supp. R. 2081).

After the Commission filed its motion, the receiver filed an amended complaint pursuing claw-back claims against several hundred additional innocent investors (USCA5 201). The receiver also moved to continue the asset freeze beyond the court's August 3, 2009 deadline (USCA5 265). The receiver requested "an order freezing certain assets . . . in the names of the Relief Defendants in an amount equal to payments of CD Proceeds received by Relief Defendants from SIB, so that this property of the Estate may be preserved and protected while the Receiver seeks an order of disgorgement" (USCA5 275).

The court held a hearing on July 31, 2009, to consider the receiver's motion for a continuation of the asset freeze and the Commission's motion to modify the receivership (Tr. USCA5 25-75). The arguments on both motions focused on the validity of the receiver's claw-back claims against innocent investors (Tr. USCA5 25-75). After the hearing, the court denied the Commission's motion to modify the receivership (No. 09-298 Doc. 674), and granted the asset freeze with respect to the value of purported CD *interest* payments that the Investor Defendants received from SIB (USCA5 478 ¶3). The court, however, agreeing with the Commission, denied the asset freeze with respect to amounts equaling purported CD *principal* repayments received by the Investor Defendants because the court found "as a matter of law that innocent investors in this case who redeemed their investments before the Receivership are not liable for return of principal, and therefore, the Receiver has failed to establish that he is likely to prevail on the merits of his claims with regard to CD principal redemption payments" (USCA5 477-78 ¶2).

The court nonetheless temporarily froze the Investor Defendants' accounts that held the purported principal repayments until August 13, 2009, in order to "afford the Receiver an opportunity to seek appellate relief from this order" (USCA5 478 ¶6). The receiver appealed from the order (USCA5 480) and sought a stay pending appeal freezing the principal repayments. On August 11, 2009, the Court granted the motion (USCA5 482).

SUMMARY OF ARGUMENT

The district court's denial of an account freeze as to principal repayments should be upheld. The district court acted within its discretion in concluding that recovery by the receiver of these amounts from the Investor Defendants is not appropriate. The receiver's claims to recover principal lack statutory and case law support, and it would be inequitable to require the innocent investors in these cases to repay these amounts.

The receiver fails to cite a single case addressing what he is attempting here – a claim by a receiver against innocent investors named as relief defendants for disgorgement of principal amounts invested in a Ponzi scheme. The receiver is unable to do so notwithstanding the existence of a wide body of case law addressing Ponzi schemes. Indeed, courts routinely apply fraudulent transfer statutes to allow receivers or trustees in bankruptcy to recover monies lost by investors in Ponzi schemes. The receiver here, however, has not asserted claims under the governing Uniform Fraudulent Transfer Act for (as his counsel acknowledged in the district court) "good reason" (Tr. USCA5 49). As demonstrated below, the receiver cannot recover the principal repayments innocent investors received from SIB as fraudulent transfers because the investors received the payments in good faith and for reasonably equivalent value.

Facing certain failure, the receiver has attempted an end run around the governing body of law. He names the Investor Defendants as "relief defendants" and seeks disgorgement from them not based on any recognized cause of action, but under the court's "equity powers." This is unwarranted on the facts of this case. Although courts have approved the relief defendant mechanism for the Commission (and other civil law enforcement agencies), the receiver does not stand in the shoes of the Commission. Additionally, the relief defendant mechanism is ill-suited to the circumstances presented here, particularly because the Investor Defendants have a legitimate claim to the amounts representing a return of their principal investment.

The cases cited by the receiver involving the pro rata distribution of receivership assets in Ponzi scheme cases address only what to do with monies already assembled into the receivership estate, not whether monies in the hands of third parties should be brought into the estate. Those cases do not address the distinct equitable considerations that are implicated when a receiver seeks the disgorgement of funds transferred by a receivership entity to innocent investors prior to the receivership.

Finally, the circumstances of this case do not support an extension of the district court's equitable authority to permit the receiver's claims against the Investor Defendants for the principal payments they received from redemption of their SIB CDs. Most of the investor defendants, a small subset of the Stanford fraud victims, have been sued as a result of the happenstance that they have accounts where the receiver was able to obtain an account freeze. Thousands of other investors likely also have received principal payments, including thousands who are beyond the district court's jurisdiction. *See* Brief of Appellees Jim Letsos, et al. ("Letsos Brief"), at 7-10. It would be unfair to make this small subset of admittedly innocent investors return the funds they invested, or even litigate the receiver's claims, while thousands of other similarly situated investors are not pursued.

The Commission therefore urges this Court to affirm the district court's ruling that innocent investors who redeemed their investments before the receivership are not liable for a return of their principal payments, and that the receiver has thus failed to establish that he is likely to succeed on the merits of his claim with respect to CD principal repayments.

ARGUMENT

The District Court Reasonably Determined that the Investor Defendants Should Not Be Liable for Principal Payments Received from SIB.

Courts "routinely" apply fraudulent transfer statutes "to allow receivers or trustees in bankruptcy to recover monies lost by Ponzi-scheme investors." *Donell v. Kowell*, 533 F.3d 762, 767 (9th Cir. 2008) (citing *In re Agric. Research & Tech. Group*, 916 F.2d 528, 534 (9th Cir. 1990) and *Scholes v. Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995)), *cert. denied*, 129 S. Ct. 640 (2008); *see also In re Slatkin*, 525 F.3d 805, 814-16 (9th Cir. 2008); *Warfield v. Byron*, 436 F.3d 551 (5th Cir. 2006). Here, however, the receiver does not seek to recover under the Uniform Fraudulent Transfer Act ("UFTA") the principal payments made to the Investor Defendants, and he could not do so because principal payments cannot be recovered from innocent investors under the UFTA. The district court reasonably rejected the receiver's attempt to avoid that limitation by invoking the court's "equity powers."

A. The receiver could not recover the principal payments the Investor Defendants received from SIB under the UFTA because those investors received the payments for reasonably equivalent value.

Under section 24.005(a) of Texas's Uniform Fraudulent Transfer Act, a receiver may avoid a transfer if the debtor made the transfer (1) with actual intent to hinder, delay, or defraud any creditor of the debtor, or (2) without receiving a reasonably equivalent value in exchange for the transfer and when the debtor was insolvent. Tex. Bus. & Com. Code § 24.005(a). Section 24.005(a)(1) codifies the actual fraud theory of fraudulent transfers; Section 24.005(a)(2) codifies the constructive fraud theory of fraudulent transfers. *See Donell*, 533 F.3d at 770 (discussing analogous provisions of California's UFTA). The receiver cannot recover the transfers of principal to the Investor Defendants under either theory.

Transfers made by an entity operating as a Ponzi scheme are fraudulent under section 24.005(a)(1) because proof that the entity operated as a Ponzi scheme "establishes the fraudulent intent behind the transfers it made." *Res. Dev. Int'l, LLC*, 487 F.3d at 301 (citation omitted). Nonetheless, a "transfer or obligation is not voidable under Section 24.005(a)(1) of this code against a person who took in good faith and for a reasonably equivalent value." Tex. Bus. & Com. Code § 24.009. It is undisputed that the Investor Defendants received the principal payments in good faith. In addition, as discussed below, the receivership entities received "a reasonably equivalent value" for the transfers. Thus, the Investor Defendants could successfully invoke section 24.009 to prevent the receiver from recovering the transfers under an actual fraud theory.

Transfers made by an entity operating as a Ponzi scheme satisfy the "insolvency" requirement under section 24.005(a)(2) because an entity that operates as a Ponzi scheme "is, as a matter of law, insolvent from its inception." *Warfield*, 436 F.3d at 558 (citing *Cunningham v. Brown*, 265 U.S. 1, 7-8 (1924)). In addition, section 24.005(a)(2) requires that the transferor receive less than a reasonably equivalent value in exchange for the transfer. The receiver, as discussed below, cannot satisfy this requirement. Thus, the receiver cannot succeed in bringing an action under a constructive fraud theory.

In considering "reasonably equivalent value" under Texas's UFTA, because the UFTA is a uniform act, courts "may look to cases decided under 11 U.S.C. § 548 [the Bankruptcy Code], as well as cases interpreting other states' versions of the Uniform Fraudulent Transfer Act (UFTA), to determine the meaning of the phrase." *Creditor's Comm. of Jumer's Castle Lodge, Inc. v. Jumer*, 472 F.3d 943, 947 (7th Cir. 2007); *see also Donell*, 533 F.3d at 769-70 ("California's fraudulent transfer act and the federal bankruptcy code's fraudulent transfer provisions are almost identical in form and substance; therefore, we draw upon cases interpreting both."); *Warfield*, 436 F.3d at 558 (relying on cases interpreting "the corresponding provision of the Bankruptcy Code, 11 U.S.C. 548," to interpret a provision in the UFTA).

"The primary consideration in analyzing the exchange of value for any transfer is the degree to which the transferor's net worth is preserved." *Res. Dev. Int'l*, 487 F.3d at 301 (citation omitted). The Act's purpose is to "protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors." UFTA § 3 cmt.2.

Therefore, transferees who receive transfers in good faith may retain the transfers to the extent that the transfers leave the debtor no worse off:

> *The purpose of fraudulent transfer law is the preservation of the debtor's estate for the benefit of its unsecured creditors. Consequently, what constitutes reasonably equivalent value must be determined from the standpoint of the debtor's creditors*. . . . Hence, the proper focus is on the net effect of the transfers on the debtor's estate, the funds available to the unsecured creditors. As long as the unsecured creditors are no worse off because the debtor, and consequently the estate, has received an amount reasonably equivalent to what it paid, no fraudulent transfer has occurred.

In re Jeffrey Bigelow Design Group, Inc., 956 F.2d 479, 484 (4th Cir. 1992) (quoting Jack F. Williams, *Revisiting the Proper Limits of Fraudulent Transfer Law*, 8 Bankr. Dev. J. 55, 80 (1991) (emphasis in original)).

Transfers to investors in a Ponzi scheme in an amount equal to their principal investment "are considered to be exchanged for 'reasonably equivalent value,' and thus not fraudulent, because they proportionally reduce the investors' rights to restitution." *Donell*, 533 F.3d at 772. An investor in a Ponzi scheme has a right to recover his principal investment "from the moment that he was deceived into paying it." *Eby v. Ashley*, 1 F.2d 971, 973 (4th Cir. 1924). The debtor's net worth is thus preserved by repaying investors in a Ponzi scheme an amount equal to their principal investment because such transfers extinguish their potential restitution claims. Investors' restitution claims are reduced regardless of whether the payments they receive up to the amount of their investment are denominated "principal" or "interest" payments. *In re Independent Clearing House Co.*, 77 B.R. 843, 857 (D. Utah 1987) ("We conclude that the debtors received a 'reasonably equivalent value' in exchange for all transfers to a defendant that did not exceed the defendant's principal undertaking . . . ."). Both investors who had not redeemed the SIB CDs and who received payments labeled as interest and investors who did redeem the CDs and received payments labeled as a return of principal are entitled to retain those payments up to the amount of their investment in the CDs.[3/]

As noted above, the Bankruptcy Code, in addition to enabling a trustee to avoid transfers that are voidable under state law, such as each state's Uniform Fraudulent Transfer Act, 11 U.S.C. 544(b)(1), contains provisions analogous to the UFTA, and the analysis under the Bankruptcy Code is the same. Under section 548(a)(1)(A) of the Code, the trustee may avoid a transfer if the debtor made the transfer with actual intent to hinder, delay, or defraud an entity to which the debtor was or became indebted. 11 U.S.C. 548(a)(1)(A). Under section 548(a)(1)(B), the trustee may avoid any transfer made within two years of the bankruptcy petition if the debtor received less than reasonably equivalent value for the transfer and was

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3/ The Commission notes that certain parties have cross-appealed the district court's decision to continue a freeze with regard to proceeds exceeding the customer's principal investments in the Stanford scheme (i.e., a freeze as to false "profits"). In certain circumstances, a properly brought claw-back claim seeking to recoup such "false profits" (in contrast to the discussion above regarding seeking principal from innocent investors) may be appropriate. That, however, is a separate question from whether the district court properly continued a freeze of those customer accounts at this time. The Commission does not express an opinion as to the particular arguments asserted before this Court by other parties concerning the propriety of the receiver's claims to the extent of net "false" profit as a result of investing in the Stanford scheme. The Commission, however, reiterates its position before the district court that, as a matter of equity, under these facts and the claims asserted here, the freeze should be lifted as to all customer accounts in their entirety.

insolvent at the time. 11 U.S.C. 548(a)(1)(B). A transferee that takes in good faith, however, may retain the interest transferred to the extent the transferee gave value to the debtor in exchange for the transfer. 11 U.S.C. 548(c). The "question of whether value has been given, for purposes of the defense to a claim for intentional fraud, appears to be analyzed by courts in the same fashion as whether reasonably equivalent value has been given for purposes of establishing constructive fraud." Mark A. McDermott, *Ponzi Schemes and the Law of Fraudulent and Preferential Transfers*, 72 Am. Bankr. L.J. 157, 176 n.75 (1998).

In making the determination whether the debtor received reasonably equivalent value for purposes of section 548, the analysis is directed at what the debtor surrendered and what the debtor received irrespective of what any third party may have gained or lost. *In re United Energy Corp.*, 944 F.2d 589, 597 (9th Cir. 1991) (citations omitted). The reason for this analysis is that the policy behind section 548 is to preserve the assets of the estate. *Id.* Accordingly, under section 548, as under the UFTA, principal repayments received in good faith by investors in a Ponzi scheme may not be recovered by the trustee because when investors receive such payments their rights to restitution from the debtor are proportionately reduced by the payments they receive. *Id.* at 595.

Thus, it is clear that if the receiver elected to pursue his claims against the Investor Defendants under fraudulent transfer law – the accepted course for receivers in cases involving Ponzi schemes – his claims would fail. As discussed below, on the facts of this case the district court reasonably rejected the receiver's attempt to avoid the settled limitations on actions under those statutes by invoking the court's equity powers.

B. The district court reasonably rejected the receiver's attempt to recover the principal payments the Investor Defendants received from SIB under equity principles because the receiver stands in the shoes of the receivership entities and it would be inequitable to allow such recovery in this case.

1. The receiver does not act on behalf of the Commission but rather stands in the shoes of the receivership entities and so cannot invoke investors' equitable claims.

The receiver states in his complaints, citing *SEC v. Colello*, 139 F.3d 674 (9th Cir. 1998), that "it is necessary to name the Relief Defendants as nominal defendants to effect full relief in the marshaling of assets that are the fruits of the underlying fraud" (*e.g.*, USCA5 215). The Commission "may name a non-party depository as a nominal defendant to effect full relief in the marshaling of assets that are the fruit of the underlying fraud" because "'federal courts have inherent equitable authority to issue a variety of "ancillary relief" measures in actions brought by the SEC to enforce the federal securities laws.'" *Colello*, 139 F.3d at

676-77 (quoting *SEC v. Wencke*, 622 F.2d 1363, 1369 (9th Cir. 1980)). The receiver, however, does not act on behalf of the Commission. *See In re Sherman*, 491 F.3d 948, 963-64 (9th Cir. 2007) (stating that "the Receiver and the SEC are independent entities" and that the receiver does not have authority to "act on behalf of the agency"); *cf. East v. Crowdus*, 302 F.2d 645, 647 (8th Cir. 1962) ("The interest of the Securities and Exchange Commission in such an action does not terminate upon the appointment of a receiver therein. . . . [N]o court would hold . . . that the Commission is without standing to give heed as to how the assets taken possession of by any such receiver are disposed of in the public interest.").

Courts have extended the relief defendant mechanism to other civil law enforcement agencies besides the Commission. *See, e.g., CFTC v. Kimberlynn Creek Ranch*, 276 F.3d 187 (4th Cir. 2002). In so doing, the courts have recognized the similarities between the Commission and these other agencies that made extending the relief defendant mechanism appropriate. For example, in *Kimberlynn Creek Ranch*, the court recognized that

> this litigation represents the [CFTC's] first attempt to obtain relief from a nominal defendant in an action for commodities fraud. The novelty of this attempt does not give us pause, however. Given the general similarity between the role of the [CFTC] and the role of the SEC in remedying wrongs within their respective spheres, it is entirely appropriate to allow the [CFTC] to proceed against nominal

> defendants under the same circumstances in which the SEC could proceed against such defendants.

276 F.3d at 192 n.4. As the receiver does not act on behalf of the Commission, the same reasoning does not apply to it.

In the case of a Ponzi scheme where some investors receive repayments from the Ponzi scheme operator and some do not, the receiver also "does not assert the rights or claims of any investors." *Scholes v. Ames*, 850 F. Supp. 707, 712 (N.D. Ill. 1994), *aff'd on other grounds sub nom. Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995). Rather, with certain exceptions not relevant here, such as the *in pari delicto* defense, *Lehmann*, 56 F.3d at 754-55, the receiver "stands in the shoes of . . . the various receivership entities. So, when asserting his equity claim, the Receiver cannot personally raise those equitable considerations of the later investors that lost their money." *Ames*, 850 F. Supp. at 712. Instead, the "equity receivership may sue only to redress injuries to the entity in receivership." *Lehmann*, 56 F.3d at 753.

2. The district court reasonably concluded that the receiver is not entitled to recover principal payments made to the Investor Defendants because even if he could invoke investors' equitable claims it would be inequitable to permit such recovery on the facts of this case.

Assuming, for purposes of argument, that the receiver could raise the equitable considerations of the later investors in the Ponzi scheme, it would still be inequitable to force the Investor Defendants to return their principal payments in this case. The receiver has recognized previously that the Investor Defendants own assets "held in separately identifiable accounts in their names or for their benefit that they established with the Stanford companies" and that "the assets in these accounts belong to the account owners" (Supp. R. 804). "A court can obtain equitable relief from a non-party against whom no wrongdoing is alleged if it is established that the non-party possesses illegally obtained profits but has no legitimate claim to them." *SEC v. Cherif*, 933 F.2d 403, 414 n.11 (1991). As demonstrated above, the Investor Defendants, in good faith, gave value for the repayments they received because they gave up their restitution claims, and thus have a legitimate claim to the repayments. The receiver has not cited, and we are not aware of, a case holding that a receiver may obtain equitable disgorgement of principal repayments from innocent investors in a Ponzi scheme.

The receiver cites *SEC v. George*, 426 F.3d 786 (6th Cir. 2005), for the proposition that "[i]nvestors in a Ponzi scheme are properly named as relief defendants and are subject to disgorgement if they received proceeds from the scheme" (Br. 23). Although *George* did involve disgorgement by investors in a Ponzi scheme, the investors were not wholly innocent. The court's opinion in *George* did not detail the reasons for the Commission's action against the relief defendants (other than the principal defendant's girlfriend). But those reasons, as the Commission explained in its motion to modify the receivership before the district court, are critical in understanding why the Commission brought the claims.

The Commission sought disgorgement in *George* from four relief defendants: Dziorny, George, Jackson, and Harris. Dziorny, the primary defendant's girlfriend, received gifts including a diamond engagement ring and cash. George received more than twice the amount of his initial investment prior to the filing of the Commission's lawsuit, and a violator funneled additional funds to him after the asset freeze was ordered. Jackson and Harris sought to obtain the release of funds from the asset freeze, including all of their principal and interest, even though they had previously received substantial Ponzi payments and refused to agree to a set-off. Claims against Jackson and Harris were necessary and appropriate to prevent them from receiving a windfall.

George, moreover, involved an action by the Commission, rather than a receiver, to recover Ponzi scheme payments. As noted above, a receiver does not stand in the shoes of the Commission. Therefore, *George* is not authority for the receiver to invoke the court's equitable powers to grant ancillary relief in Commission enforcement actions.

The receiver also contends that the case law universally supports a pro rata distribution of receivership estate assets and that investor claimants must share the assets – and the pain of loss – equally in the aftermath of a Ponzi scheme's collapse (Br. 16). The equity of distributing receivership estate assets pro rata, however, has no bearing on whether the receiver may, under equitable principles, claw back principal payments made to innocent investors in order to increase the assets available for distribution. When funds are not in the receivership estate but have been transferred to investors, markedly different equities are implicated that do not arise in the context of the approval of a distribution plan.

To be sure, "[d]istrict courts have wide equitable discretion in fashioning distribution plans in receivership proceedings," *SEC v. Infinity Group Co.*, 226 Fed. Appx. 217, 218 (3d Cir. 2007), and "[c]ourts have favored *pro rata* distribution of assets where . . . the funds of the defrauded victims were commingled and where victims *were similarly situated* with respect to their relationship to the defrauders." *SEC v. Credit Bancorp*, *Ltd.*, 290 F.3d 80, 88-89 (2d Cir. 2002) (emphasis added). Conversely, however, where defrauded victims are not similarly situated, such as where some investors in the Ponzi scheme have received repayments and some have not, "it would [not] be inequitable for the defendants to retain the payments to them. The defendants accepted the money from the [defrauding entity] in a good faith belief that the [defrauding entity] was performing its contractual obligations. The [defrauder] as an entity has no justifiable claim on the money it paid investors. . . . In such circumstances the courts may simply leave the parties where they were found." *Johnson v. Studholme*, 619 F. Supp. 1347, 1350 (D. Colo. 1985); *cf. Chosnek v. Rolley*, 688 N.E. 2d 202, 210-11 (Ind. App. 1997) ("[A]n innocent investor in a Ponzi scheme is not unjustly enriched when he receives returns on his investment in good faith and while ignorant of the scheme, so long as the returns do not exceed the amount of the original investment. To the extent of the original investment, such are not subject to claims made by later investors on the theory of unjust enrichment.").

Moreover, although a pro rata distribution of receivership assets is permissible, it is not required. As noted above, the "district court has broad powers and wide discretion to determine the appropriate relief in an equity receivership." *SEC v. Elliott*, 953 F.2d 1560, 1569-70 (11th Cir. 1992), *rev'd in part on other* *grounds*, 998 F.2d 922 (11th Cir. 1993). In *Elliott*, the court found that the district court erred in not allowing one creditor to demonstrate that he was entitled to set off a debt he owed the receiver against the debt the receiver owed him. The court rejected the receiver's argument that the creditor would receive a preference over other investors if he were allowed a setoff because they would only receive a return of a percentage of their investments and the creditor, up to the amount of the debt, would receive a dollar for dollar return on his investment. Instead, the court found that in "the [creditor's] case, the Receiver is reaching out to pull money into the fund" and that this was "quite a different situation from that of the other claimants. The other claimants were not permitted to trace into the receivership because they were all defrauded in the same way, and the remaining funds were insufficient to cover their claims. . . . It would be difficult for equity to permit the Receiver to bring money into the receivership from someone who was defrauded by [the defrauder]. In effect, equity would be sanctioning further torment of a defrauded investor." *Id.* at 1573-75.

The receiver contends that *United States v. Durham*, 86 F.3d 70 (5th Cir. 1996), and *SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325 (5th Cir. 2001), "supports [sic] disgorgement claims against investors who cashed out of a Ponzi scheme at the expense of other investors shortly before court intervention" (Br. 18). These cases, however, involved plans of distributions of assets already in the receivership estate rather than attempts to recover assets for the receivership estate. In *Durham*, the court held that the district court did not abuse its discretion in distributing assets to defrauded investors pro rata rather than imposing a constructive trust in favor of a defrauded investor who was able to trace its funds. 86 F.3d at 73. *Forex* relied on *Durham* to affirm a pro rata distribution plan even where one defrauded investor was able not only to trace its funds but to show that its funds were not commingled with the funds of other defrauded investors. 242 F.3d at 331. As neither case involves a receiver's attempt to claw back funds transferred to innocent investors, they do not support the receiver's contention that "Fifth Circuit precedent supports the Receiver's claims" (Br.18).

Similarly, the receiver cites *Infinity Group Co.*, 226 Fed. Appx. 217, for the proposition that "the timing of the relief defendants' CD redemptions does not give them equitable priority over thousands of other Stanford victims" (Br. 26). In *Infinity Group*, the court refused to find that the district court abused its discretion by ordering a pro rata distribution of assets even though one investor claimed that the defrauding entity never had access to his funds because his check did not clear before the defrauding entity's account was frozen. The receiver himself characterizes the holding as "refusing to allow an investor to receive back an investment check that had not yet cleared at the time of the receivership" (Br. 25). Here, however, the innocent investors are not seeking to receive back their principal investments. Instead, the receiver is seeking to prevent the innocent investors from retaining the principal payments returned to them before the receiver was appointed. That some courts authorize a pro rata distribution of receivership assets does not mean, therefore, that claw-back claims against innocent investors are appropriate; it would be inequitable to claw back from the Investor Defendants repayments of their principal investment.

None of the receiver's cases demonstrates that it would be equitable to allow these claw-back claims for principal repayments against the innocent Stanford investors. Such claims would exacerbate the hardship on a small pool of victims who happen to hold funds in identifiable accounts that could be frozen. Although thousands of other investors likely also have received principal payments, these investors are likely beyond the court's jurisdiction. Pursuing claims against a small subset of admittedly innocent investors for the return of the funds they invested would come at great cost to these victims and the receivership estate, and with questionable benefit to all of the victims of the Stanford scheme. These funds are likely a small percentage of the billions owed to Stanford investors worldwide, would likely be consumed by the high expense of pursuing these claims, and would not contribute to investor recovery in a meaningful way. Requiring the return of these funds, however, would further harm the innocent investors who received them. "To undo all of these transactions would cause incalculable harm to hundreds of people, at a staggering cost, for which no commensurate benefit would lie." *In re Independent Clearing House Co.*, 41 B.R. 985, 1005 n.20 (Bankr. Utah 1984) (rejecting trustee's attempt to recover all repayments made to investors in Ponzi scheme pursuant to the court's equitable powers in order to "enable him to redistribute such funds ratably among all investors" because "[a]s a court of equity, the bankruptcy court must consider the balance of hurt"), *aff'd in part, rev'd in part*, 77 B.R. 843, 855 & n.19 (D. Utah 1987) ("The trustee first argued that the bankruptcy court has the inherent equitable power to avoid all transfers to undertakers [investors] in a Ponzi scheme. The bankruptcy court summarily rejected this argument, and properly so. . . . Even were we to find for the trustee on his first theory, the result here would not be equitable.").

C. The other cases cited by the receiver do not support his attempts to claw back the principal repayments the Investor Defendants received.

The receiver cites several cases (Br. 23 n.2) for the proposition that "[c]ase law amply supports the power of a receiver to seek disgorgement of tainted funds from relief defendants who receive proceeds from a Ponzi scheme." Only one of the cited cases, *SEC v. Dowdell*, 2002 WL 31357059 (W.D. Va. Oct. 11, 2002), even involved a claim by a receiver, and none of the cited cases involved a claim for disgorgement from an innocent investor. *See* Appendix to the Letsos Brief.

The receiver also cites numerous cases for the proposition that the investors here have no legitimate claim to the funds and the receiver is therefore "entitled to exclusive possession and control of those funds" (Br. at 29-31). The receiver's reliance on all of the cases is misplaced. With the exception of the *SEC v. George* case addressed *supra*, none of the cases involved an action against an investor. Moreover, the courts generally did not conclude, as the receiver here suggests, that monies that were the proceeds of fraud were *ipso facto* monies as to which the relief defendant had no legitimate claim. Rather, the courts considered grounds upon which even proceeds of fraud might be legitimately claimed by a relief defendant. A short summary of the relevant aspects of each case is provided below (in the order cited by the receiver):

> *CFTC v. Kimberlynn Creek Ranch*, 276 F.3d 187, 190-92 (4th Cir. 2002): The nominal defendants held funds on behalf of the principal defendants. The district court found no evidence to support the nominal defendants' claim that they received the funds from the principal defendants as payment for services rendered, and this finding was not clearly erroneous.
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> *SEC v. Cavanagh*, 155 F.3d 129, 137 (2d Cir. 1998): The nominal defendant was the wife of one of the principal defendants. The court found that she had no valid ownership claim to proceeds from sales of stock where her

husband transferred the stock to her and sold it from her account without her knowledge because a defendant cannot circumvent the SEC's power to recapture fraud proceeds by transferring stock to friends and relatives.

SEC v. Colello, 139 F.3d 674, 678 (9th Cir. 1998): The nominal defendant obtained letters of credit for the defrauding entity. The court found disgorgement of the funds he received from the defrauding entity proper because he invoked the Fifth Amendment and "refused to give information necessary to determine whether he still possessed any of the funds or whether he had a legitimate claim to them."

SEC v. China Energy Savings Tech., Inc., 2009 WL 1940794, at *7-8 (E.D.N.Y. July 6, 2009): The relief defendants held proceeds of a pump and dump scheme. The court ordered disgorgement because the principal defendant "controlled and directed sales of the stock in the Relief Defendant accounts" and the relief defendants "failed to make any showing that the shares of [the stock] were received in exchange for adequate consideration."

SEC v. Byers, 2009 WL 33434, at *2-3 (S.D.N.Y. Jan. 7, 2009): The relief defendants were related to the principal defendant and received the property subject to the asset freeze from the principal defendant for $1. The court found that the relief defendants had no legitimate claim to the property because the property was "inextricably intertwined with [the defendant's] allegedly fraudulent business dealings."

CFTC v. Nations Invs., LLC, 2008 WL 4376887, at *6 (S.D. Fla. Aug. 25, 2008): The relief defendants were "insiders" of the principal defendant corporation. The court found that transfers made by the principal defendant corporation to pay off the home equity loans of the relief defendants were fraudulent transfers that must be disgorged. The relief defendants did not provide consideration for the repayment of the home equity loans.

SEC v. AmeriFirst Funding, Inc., 2008 WL 1959843, at *5-6 (N.D. Tex. May 5, 2008): The relief defendant was controlled by the principal defendant and received millions of dollars of investor money as "consulting fees." The court ordered disgorgement because although the relief defendant "might have had a legitimate claim to 'consulting fees' had it been unaware that its consulting services were furthering securities fraud, [the relief defendant] cannot invoke a good faith defense because its head, [the principal defendant], was a principal actor in the securities fraud scheme."

FTC v. Holiday Enters., Inc., 2008 WL 953358, at *12 (N.D. Ga. Feb. 5, 2008): The relief defendant was incorporated by an officer and director of the principal defendants and his wife served as the relief defendant's president and director. The court ordered disgorgement of funds and properties transferred to the relief defendant because it had no legitimate claim to the properties. The wife of the officer and director of the principal defendants never performed any work for the principal defendants and would not have a legitimate claim to the properties because of any such work.

CFTC v. Foreign Fund, 2007 WL 1850007, at *5 (M.D. Tenn. June 25, 2007): One relief defendant was the custodian of certain customer funds of the principal defendant that operated a Ponzi scheme and the other relief defendant was an entity that received customer funds from the principal defendant. The relief defendants failed to respond to the CFTC's motion for partial summary judgment, and the court, pursuant to a local rule, deemed the CFTC's statement of material facts not disputed. The court granted the motion because the CFTC established that customer funds of the principal defendant were sent to the relief defendants, and the relief defendants did not generate any genuine issues of material fact about the nature of the funds.

FTC v. Transnet Wireless Corp., 506 F. Supp. 2d 1247, 1273 (S.D. Fla. 2007): The relief defendant was the wife of a principal defendant. The court ordered disgorgement from the relief defendant because she received funds from the principal defendant corporations and did not provide any services to these companies to warrant the payments.

CFTC v. Schiera, 2006 WL 4586786, at *6 (S.D. Cal. Dec. 11, 2006): The relief defendants were corporations for which a principal defendant served as president. The court, after the relief defendants failed to appear or defend the action, ordered disgorgement of the funds they received from the principal defendants' fraud. The relief defendants did not provide services to the principal defendants that gave them a legitimate claim to the funds and rather used some of the funds to pay for the principal defendants' personal expenses.

CFTC v. Int'l Berkshire Group Holdings, Inc., 2006 WL 3716390, at *10 (S.D. Fla. Nov. 1, 2006): The relief defendants received funds from the principal defendants' fraudulent activities. The court, after a default, ordered disgorgement because the relief defendants did "not appear to have provided any legitimate services in exchange for the payments they received."

CFTC v. Valko, 2006 WL 2582970, at *6 (S.D. Fla. Aug. 16, 2006): The relief defendants "received funds from the defendants that were obtained through fraudulent activities." The court ordered disgorgement because the relief defendants did "not appear to have provided any legitimate services in exchange for the payments they received," but rather "appear[ed] to be vehicles by which [the principal defendant] and others hid assets and moved customer funds to off-shore accounts."

SEC v. Cavanagh, 2004 WL 1594818, at *31-32 (S.D.N.Y. July 16, 2004): Two of the relief defendants were the wives of principal defendants and a third relief defendant was a business associate of a principal defendant. The relief defendants received proceeds from the sale of stock in a pump and dump scheme. The court ordered disgorgement from the relief defendants because they did not give consideration for the shares of stock they received.

SEC v. Renaissance Capital Mgmt., Inc., 2003 WL 23353464, at *4 (E.D.N.Y. Aug. 25, 2003): The relief defendants were the principal defendant's parents and a company owned by them. The court ordered disgorgement against the relief defendants because the funds transferred to the relief defendants from the principal defendant were obtained from investors on fraudulent grounds and the relief defendants had no legitimate claim to the funds, even though principal defendant owed them money, because the investors did not owe the relief defendants money.

SEC v. Elfindepan, S.A., 2002 WL 31165146 at *4-5 (M.D.N.C. Aug. 30, 2002): The relief defendants were a corporation that entered into a transaction with the principal defendants and the corporation's founder. The court found that the relief defendants had no legitimate claim to the funds they obtained from the principal defendants because the transaction that they engaged in with the principal defendants was a fraudulent transaction.

SEC v. Lybrand, 200 F. Supp. 2d 384, 398 (S.D.N.Y. 2002): The relief defendants were trusts benefitting the principal defendants' children. The court ordered disgorgement from the trusts of funds fraudulent obtained by the principal defendants and transferred to the trusts because the trusts did not have a legitimate claim to the funds.

SEC v. Chem. Trust, 2000 WL 33231600, at *11-12 (S.D. Fla. Dec. 19, 2000): The relief defendant received funds fraudulently obtained from the principal defendants' customers as part of a Ponzi scheme. The court ordered disgorgement because the relief defendant had "not demonstrated any bona fide reason for its possession of any of the investment funds."

CFTC v. IBS, Inc., 113 F. Supp. 2d 830, 852-53 (W.D.N.C. 2000): The relief defendants received customer funds diverted to them from the principal defendants. The court held that relief defendants did not have a legitimate claim to the funds because the relief defendants did not substantiate their assertion that the funds represented payment for services rendered.

SEC v. Milan Capital Group, 2000 WL 236374, at *3 (S.D.N.Y. Mar. 1, 2000): The relief defendant was the president of the principal defendant. He received funds that the principal defendant improperly obtained from investors. The court found that he had no legitimate claim to such payments.

SEC v. Antar, 15 F. Supp. 2d 477, 533 (D.N.J. 1998): The relief defendants were the children and grandchildren of the principal defendants. The court ordered disgorgement of the proceeds of stock sales made on the relief defendants' behalf by the perpetrator of the fraud.

SEC v. Cavanagh, 1 F. Supp. 2d 337, 386 (S.D.N.Y. 1998): The relief defendants received shares of stock at the direction of a principal defendant. The court ordered a freeze of the proceeds of sales of the stock because the principal defendant gave the shares to relief defendants as gifts and did not receive consideration for the shares.

SEC v. Infinity Group Co., 993 F. Supp. 324, 331-32 (E.D. Pa. 1998): The relief defendants were trusts for which a relative of a principal defendant served as trustee. The court ordered disgorgement of funds transferred to the trusts despite the trustee's claim that she gave consideration for the funds in the form of administrative and clerical services to a principal defendant operating a Ponzi scheme. The court found that to the extent the relief defendant earned the funds "she did so in the service of the very unlawful offering and sale of securities which is the subject of these proceedings."

SEC v. Antar, 831 F. Supp. 380, 401-02 (D.N.J. 1993): The relief defendants were the children of the perpetrator of a fraud. The court ordered disgorgement of the proceeds of stock sales in the relief defendants' accounts made by the fraud perpetrator.

CONCLUSION

For the foregoing reasons, at a minimum, the receiver has failed to demonstrate that he is likely to succeed on the merits of his claim for the return of the principal repayments, and the order of the district court therefore should be affirmed.

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitations of Fed. R. App. P. 29(d) and Fed. R. App. P. 28.1(e)(2)(B) because this brief contains 8241 words, excluding the Table of Contents, Table of Authorities, Interest of the Commission, Certificate of Compliance, and Certificate of Service.

I also certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using WordPerfect 11 in 14 point Times New Roman type.

/s/ Benjamin L. Schiffrin
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October 8, 2009

CERTIFICATE OF SERVICE

I hereby certify that on October 8, 2009, I caused seven paper copies and one electronic copy of the Brief of the Securities and Exchange Commission, Amicus Curiae, to be served via Federal Express overnight delivery on the Clerk of the Court of Appeals for the Fifth Circuit. I certify further that on that same date I caused two paper copies and one electronic copy of the brief to be served via Federal Express overnight delivery on the following counsel of record:

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