**No. 09-10761**

In The United States Court of Appeals
For The Fifth Circuit

RALPH S. JANVEY,

Plaintiff - Appellant - Cross-Appellee

v.

JAMES R. ALGUIRE; VICTORIA ANCTIL; SYLVIA AQUINO; JONATHAN BARRACK, NORMAN BLAKE, ET AL; 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 HADDED MILAN; SINGAPORE PUNTAMITA PTE., LTD.; NUMA L. MARQUETTE; GAIL G. MARQUETTE,

Defendants - Appellees - Cross-Appellants

TIFFANY ANGELLE; MARIE BAUTISTA; TERAL BENNETT; SUSANA CISNEROS; RON CLAYTON, ET AL 3; HANK MILLS; ROBERTO ULLOA; CHRISTOPHER ALLRED; PATRICIA A. THOMAS, JAY STUART BELL; GREGORY ALAN MADDUX; DAVID JONATHAN DREW; ANDRUW RUDOLF BERNARDO JONES; CARLOS FELIPE PENA; JOHNNY DAVID DAMON; BERNABE WILLIAMS,

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 No. 3-09-CV-00724-N

# BRIEF OF DEFENDANT-APPELLEES JAY STUART BELL, GREGORY ALAN MADDUX, DAVID JONATHAN DREW, ANDRUW RUDOLF BERNARDO JONES, JOHNNY DAVID DAMON, AND BERNABE WILLIAMS

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## CERTIFICATE OF INTERESTED PERSONS

Pursuant to 5th Cir. R. 28.2.1, the undersigned counsel for Defendant-Appellees Jay Stuart Bell, Gregory Alan Maddux, David Jonathan Drew, Andruw Rudolph Bernardo Jones, Carlos Felipe Pena, Johnny David Damon, and Bernabe Williams certifies that the following listed persons and entities as described in the fourth sentence of 5th Cir. R. 28.2.1 have an interest in the outcome of this appeal, No. 09-10761. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

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## STATEMENT REGARDING ORAL ARGUMENT

Defendant-Appellees Jay Stuart Bell, Gregory Alan Maddux, David Jonathan Drew, Andruw Rudolph Bernardo Jones, Carlos Felipe Pena, Johnny David Damon, and Bernabe Williams (collectively the "Seven Investors") request oral argument. The Seven Investors are wholly innocent victims of a highly publicized and financially devastating alleged Ponzi scheme involving Certificates of Deposit ("CD"s). Like many other victims, the Seven Investors, redeemed these CDs and received the return of their original principal investment prior to the discovery of the alleged Ponzi scheme and subsequent receivership imposed by the District Court. Notwithstanding the Seven Investors' alleged innocence and lack of knowledge, the Receiver seeks to reclaim all pre-receivership transfers – including those transfers that merely returned the victims' original principal investments. The Receiver contends (without supporting precedent) that these innocent and unknowing investors have no legitimate claim or ownership interest in those pre-receivership transfers and therefore are proper "relief defendants." The Receiver's clawback theory is entirely novel and lacks precedential support. The Receiver's reliance on and citation to this Circuit's precedents regarding receivership distribution plans is wholly inapposite to the situation presented here. Oral argument will assist the Court in clarifying the rule of law in this Circuit regarding the Receiver's novel clawback theory.

## RECORD REFERENCES

In this Brief the following record citation forms will be used:

| | |
|---|---|
| Citations to the Record on Appeal from matter No. 3:09-CV-0724-N | **USCA5 [page]** |
| Citations to the Supplemental Record from matter No. 3:09-CV-0298-N | **SR [page]** |
| Citations to Record Excerpts | **RE [page]** |

# TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**Page(s)**

**CASES**

**STATUTES**

**OTHER AUTHORITIES**

## STATEMENT OF THE ISSUES

1. Did the District Court abuse its discretion in denying a Preliminary Injunction when it heard and considered argument on factual issues and concluded that the Receiver could not demonstrate a likelihood of success on the merits of his clawback claims for the legitimate investment principal of wholly innocent victim-investors.

2. Did the District Court abuse its discretion in denying a Preliminary Injunction when it has concluded that innocent investors have a legitimate ownership interest in their principal investment into a Ponzi scheme and therefore cannot be proper "relief defendants."

3. Did the District Court abuse its discretion in denying a Preliminary Injunction when it concluded that innocent investors received transfers from Stanford International Bank prior to the institution of this Receivership in good faith and in exchange for reasonably equivalent value, and therefore those transfers are not subject to a constructive trust.

## STATEMENT OF THE CASE

These Seven Investors are wholly innocent victims of the alleged fraud perpetrated by R. Allen Stanford and the entities he controlled ("Stanford"). For more than fifteen years, Stanford operated a privately held group of companies under the brand Stanford Financial Group. SR 10. Stanford International Bank ("SIB") is an affiliate of Stanford Financial Group, whose primary business (and primary source of revenue) was the sale of certificates of deposit that purported to yield returns far greater than conventional certificates of deposit. USCA5 276; see also SR 11. On February 17, 2009, the U.S. Securities and Exchange Commission ("SEC") filed an enforcement action accusing Stanford of fraud in connection with SIB certificates of deposit. SR 3-28. Also on February 17, 2009, the District Court appointed the Appellant, Ralph S. Janvey, as Receiver charged with marshaling and preserving the remaining assets of Stanford Financial Group and its affiliated entities. SR 83-95.

On June 22, 2009 the Receiver named the Seven Investors as so-called "relief defendants" and filed clawback actions against them. The Receiver sought to reclaim redemption payments they had received from SIB prior to the SEC's enforcement action and the institution of this receivership. USCA5 55-68; RE-89-102. The Seven Investors, however, neither participated in the underlying fraudulent scheme nor otherwise committed any wrongdoing. USCA5 56; USCA5

204 (same); USCA5 273 (same). Like many other victim-investors, these Seven Investors redeemed their original investment (and interest earned from their SIB CDs) in the normal course of business. SR 1956-1977. This redemption occurred long before the initiation of the SEC action. USCA5 62-63; RE 67-68.

On June 29, 2009, after investor-victims had their investment accounts frozen for over four months, the District Court expressed concern about the viability of the Receiver's ability to reach this money and issued an Order stating that "it is time now" for the Receiver to test his clawback claims. SR 2042. The District Court gave the Receiver until August 3, 2009 to assert clawback claims against individual investors. SR 2042-2043; RE 103-104.

On July 20, 2009, the SEC filed Plaintiff's Emergency Motion to Modify Receivership Order requesting the District Court to transfer authority for pursuing claims against Stanford investors to the SEC. SR 2073-2080; RE 81-88. In a extraordinarily unusual, yet remarkably telling move, the SEC disagreed with the Receiver's clawback theory and challenged the viability of the Receiver's clawback actions. *Id*.

On July 28, 2009, in response to the District Court's June 29, 2009 Order, the Receiver amended his Complaint to add more than 600 investor-victims as "relief defendants." USCA5 201-249. In addition, the Receiver also filed his Motion for Order Freezing and For Disgorgement of Assets Held in the Names of

Certain Relief Defendants (USCA5 265-293) and his Motion for Order Establishing Summary Proceedings and for Expedited Consideration of Request for Continued Account Freeze. USCA5 250 – 264.

On July 31, 2009, the District Court held a hearing to consider both the SEC's Emergency Motion to Modify the Receivership Order and the Receiver's Motion for an Order Freezing Assets and For Disgorgement of Assets Held in the Names of Certain Relief Defendants. USCA 25-75. After the hearing, the District Court denied the SEC's request to modify the Order Appointing the Receiver and denied in part the Receiver's request for an asset freeze, concluding that the Receiver could not prevail on the merits of his clawback claims for principal. USCA5 468-470.

## STATEMENT OF FACTS

SIB is alleged to have operated a Ponzi scheme that marketed and sold CDs to customers worldwide. SR 10-12. Many investors redeemed their CDs prior to the discovery of the alleged fraud and subsequent enforcement actions. SR 1956-1977.

The Seven Investors, Jay Stuart Bell, Gregory Alan Maddux, David Jonathan Drew, Andruw Rudolf Bernado Jones, Carlos Felipe Pena, Johnny David Damon and Bernabe Williams,[1] are wholly innocent victims of the SIB scheme. USCA5 56; RE

[1] In total, there are more than 600 alleged relief defendants whose assets might be at issue in this action. This brief is submitted on behalf of seven of them: Jay Stuart Bell, Gregory Alan Maddux, David Jonathan Drew, Andruw Rudolf Bernado Jones, Carlos Felipe Pena, Johnny David

61. ("The Receiver does not allege that the Relief Defendants participated in the fraudulent schemes at issue in this case or otherwise committed any wrongdoing."). The Seven Investors' invested a small portion of their assets in SIB CDs. *Id*. Each of the Seven Investors redeemed the entirety of their initial investment in SIB CDs prior to the filing of the SEC's enforcement action. USCA5 62-63; RE 67-68. Specifically, these individuals redeemed their investments in SIB, respectively, on November 11, 2008; January 23, 2009; November 10, 2008; October 29, 2008; November 12, 2008; October 29, 2008; and October 28, 2008. *Id*.

On February 17, 2009, the SEC filed an enforcement action alleging, in effect, that the SIB CD operation was a fraudulent Ponzi scheme. *SEC v. Stanford International Bank, Ltd., Stanford Group Company, Stanford Capital Management, LLC, R. Allen Stanford, James M. Davis, and Laura Pendergest-Holt*, Civil Action No. 3:09-CV-0298-N (the "SEC Action"). SR 3-28. Simultaneously, the SEC asked the District Court to appoint a Receiver and to freeze all assets related to the SIB Defendant entities. SR 36-70, 73-82. The District Court appointed Ralph S. Janvey as the Receiver (hereinafter "Appellant" or "Receiver") for Stanford International Bank, Ltd., Stanford Group Company,

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Damon and Bernabe Williams. To avoid confusion and comply with Fed.R.App.P. 28(d) these seven individuals shall be referred to herein as the "Seven Investors."

Stanford Capital Management, LLC, R. Allen Stanford, James M. Davis, and Laura Pendergest-Holt. SR 85-95.

The District Court also issued a Temporary Restraining Order freezing assets and accounts related to the Stanford Group Company. SR 73-82. The District Court applied the asset freeze to custodial accounts held on behalf of the investors and customers of Stanford Financial Group held at JPMorgan and Pershing, LLC ("Pershing"). *Id*; SR 466-467. As a result, Stanford Financial Group customers, including these Seven Investors, had legitimate investments – wholly unrelated to the alleged Ponzi scheme – frozen at SIB for months. SR 1961, 1965-1966, 2013.

At the behest of the Receiver, the District Court froze the entirety of the Seven Investors' accounts at Pershing to preserve the Receiver's clawback claim against them. SR 73-82, 466-467. Ultimately, the Seven Investors and the Receiver agreed to the release of some of their frozen assets. USCA5 56; RE 61. However, the Receiver continued to assert that he was entitled to clawback in excess of $9.5 million from these Seven Investors despite his concession that only $338,243.61 of the approximately $9.5 million, represents interest from SIB. USCA5 62-63; RE 67-68. The remainder of the $9.5 million represents the Seven Investors' original principal investments in SIB CDs. *Id.*

On March 2, 2009, the District Court converted the Temporary Restraining Order into an Agreed Preliminary Injunction. SR 128-133. On April 20, 2009, at the request of aggrieved investors frustrated with the Receiver, the District Court appointed John J. Little, Esq. as Examiner (the "Examiner"). SR 473-476. The District Court asked the Examiner 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 investors …" SR 473.

Since that time, the Receiver has selectively released some accounts while holding on to others. SR 2034. Specifically, the Receiver maintains that certain accounts must remain frozen to ensure the future clawback of alleged profits of the scheme, even in the cases where the investors were wholly innocent fraud victims and the money sought was equal to or less than the initial investment principal. SR 1988. In a significant and uncommon move, both the SEC and the court-appointed Examiner opposed these clawback claims for legal, equitable, and practical reasons. SR 2073-2080, 1956-1977; RE 81-88.

On June 22, 2009, the Receiver filed a clawback action against these Seven Investors. USCA5 55-68; RE 89-102. The Receiver – and not the SEC – named them as "relief defendants" in an existing lawsuit he had previously filed against Stanford Group Company's registered representatives. *Id*; see also, USCA5 25-54; RE 30-59. Even prior to the Receiver's clawback action against the Seven Investors, the SEC opposed the

Receiver's novel contention that an investor could be properly considered a "relief defendant." SR 2078, n. 9; RE 86. Notably, the Receiver did not allege a cause of action under fraudulent transfer law as is typically done when receivers bring such actions in cases involving Ponzi schemes. USCA5 55-68; RE 60-73. The Receiver neither sought to amend the Original Complaint nor assert an actual cause of action against the Seven Investors. *Id*. Rather, in contravention of established precedent, the Receiver sought to recover both principal and interest from these innocent Seven Investors under general equity principles. *Id.*

By June 29, 2009, the District Court had concerns about the viability of the Receiver's clawback claims for innocent investors' original principal investments in SIB and the continued freeze of investors' accounts. SR 2042-2043; RE 103-104. The District Court entered the following order:

> The Court finds that the freeze has lasted long enough to permit the Receiver to assess whether he has viable claims against the various individual investors, and that it is time now for those claims to be asserted and tested. . . . The Court finds that five additional weeks should give the Receiver sufficient time to assess whether he wants to assert claims against individual investors and to assert such claims in a proceeding ancillary to the receivership action, together with claims for prejudgment attachment. SR 2042; RE 103.

Recognizing the burden imposed by the asset freeze, the District Court's Order also stated that "its prior orders freezing the accounts of individual investors are vacated … effective noon, August 3, 2009." SR 2043; RE 104.

On July 20, 2009, after continued discussions with the Receiver regarding the viability of these claims, the SEC took the unprecedented steps of challenging the Receiver's legal basis for pursuing such claims and requesting the District Court amend the receivership order to strip the Receiver of the ability to pursue claims against investors. SR 2073-2080; RE 81-88; USCA5 30; RE 35.[2]

On July 28, 2009, in response to the District Court's Order, the Receiver amended his initial clawback claim against these Seven Investors and added approximately 600 more innocent investors as "relief defendants." USCA5 201-249. The Receiver also requested that the District Court extend the asset freeze over the accounts of each alleged "relief defendant." USCA5 265-293.

On July 31, 2009, the District Court conducted a lengthy hearing on the SEC's motion to modify the receivership order and the Receiver's motion to establish a new asset freeze over the accounts of the named "relief defendants." At this hearing the SEC made clear that it sought to modify the receivership order "simply because we don't believe that there's any legal support to sue innocent investors for clawback claims of principal." USCA5 28 at pg. 4:4-7; RE 33. Specifically, the SEC argued that the alleged "relief defendants" have a legitimate

[2] **Court**: Have you-all ever asked a court to rein in a receiver before? You know, I certainly haven't read every SEC case, but this was a little bit of a new one for me. **Mr. Edmundson** (SEC): I'm not aware of one… I am not aware of any time where the receiver has – has – or where the SEC has come in to try to curb some of the authority of the receiver. We – we filed this motion after great deliberation internally and after a lot of discussion with the Examiner and Receiver. USCA5 30, pg. 6:2-16; RE 35.

right and ownership interest in amounts equal to their principal investments and that the application of established precedent to the instant facts foreclosed the ability of the Receiver to recover principal. USCA5 29 at pg. 5:3-14; RE 34. Finally, the SEC noted that the Receiver's pursuit of this narrow band of investor-victims is inequitable given his legal inability to pursue the lion's share of SIB investors who received redemption and/or interest payments from SIB and are outside the jurisdiction of the District Court. USCA5 32, pg. 8:17-23; RE 37.

The SEC was not alone in its strong disagreement with the Receiver's novel approach. The Examiner echoed the SEC's legal arguments and also argued that the Receiver's pursuit of the alleged "relief defendants," who by chance had their accounts at Pershing, was contrary to prevailing views of equity. USCA5 36 at pg. 12:10-16; RE 41. Further, in response to questioning from the District Court, the Examiner expressly noted that even investors who would be advantaged by the Receiver's claim recognized that clawback claims for principal are inequitable. USCA5 37 at pg. 13:1-4; RE 42.

The District Court heard extensive argument from the Receiver on the facts, the legal precedent, and his novel approach. The Receiver argued that the concept of pro rata distribution mandated that all investors are treated equally and therefore all transfers from SIB to investors should be reclaimed and be redistributed on a pro rata basis. USCA5 47-48; RE 52-53. The Receiver argued that had the

receivership been instituted prior to redemption payments to "relief defendants," the investors would not have a claim for the funds the Receiver seeks to "clawback." *Id*. As a result, the Receiver argued that the court should ignore the date of the transfers, permit the Receiver to clawback all funds (including principal), and distribute all collected funds pro rata. *Id*.

After the hearing, the District Court issued an Order denying the Receiver's request for an asset freeze over amounts equal to the alleged "relief defendants'" principal or initial investment. The District Court concluded that the Receiver could not prevail on the merits of his claim to clawback principal from innocent investors. After hearing argument on the facts and law, the District Court concluded that the Receiver could not demonstrate a likelihood that he would prevail on the merits of his claim.[3]

## STANDARD OF REVIEW

The instant action is an appeal of the District Court's denial of a request for Preliminary Injunction. The District Court's Order should be reviewed for an abuse of discretion. *Ashcroft v. American Civil Liberties Union*, 542 U.S. 656, 664 (2004); *Lake Charles Diesel, Inc. v. General Motors Corp.*, 328 F.3d 192, 195 (5th Cir. 2003); *Black Fire Fighters Ass'n of Dallas v. Cty. of Dallas*, 905 F.2d 63, 65

[3] The dispositive Order was drafted by the Receiver (in consultation with the SEC and Examiner) and submitted to the District Court for signature. While the Order does not spell out in lengthy detail the grounds on which the District Court reached its decision, the District Court's comments and analysis during the oral argument and hearing, coupled with the Order, make clear the District Court's reasoning and conclusions. USCA5 74; RE 79.

(5th Cir. 1990); *White v. Carlucci*, 862 F.2d 1209, 1211 (5th Cir. 1989)(quoting *Apple Barrell Prods, Inc. v. Beard*, 730 F.2d 384, 386 (5th Cir. 1984)). This Court repeatedly has made clear that it will "not simply substitute [its] judgment for the trial court's, else that court's discretion would be meaningless." *Carlucci*, 862 F.2d at 1211 (quoting *Ent. Int'l, Inc. v. Corp. Estatal Petrolera Ecuatoriana*, 762 F.2d 464, 472 (5th Cir. 1985)). A district court only abuses its discretion if it: (1) relies on clearly erroneous factual findings, (2) relies on erroneous conclusions of law, or (3) misapplies the law to the facts. *In re Volkswagen of Am., Inc.*, 454 F.3d 304, 310 (5th Cir. 2008)(citing *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 416 (1975); *McClure v. Ashcroft*, 335 F.3d 404, 408 (5th Cir. 2003)).

To obtain a preliminary injunction, the applicant must show: (1) a substantial likelihood that he will prevail on the merits, (2) a substantial threat that he will suffer irreparable injury if the injunction is not granted, (3) that his threatened injury outweighs the threatened harm to the party whom he seeks to enjoin, and (4) that granting the preliminary injunction will not disserve the public interest. *PCI Transp., Inc. v. Fort Worth & W. R. Co.*, 418 F.3d 535, 545 (5th Cir. 2005). This Court has cautioned repeatedly that a preliminary injunction is an extraordinary remedy which should not be granted unless the party seeking it has clearly carried the burden of persuasion on all four requirements. *Id.* (quoting *Women's Med. Ctr. v. Bell*, 248 F.3d 411, 419 (5th Cir. 2001). "Only under

'extraordinary circumstances' will [this Court] reverse the denial of a preliminary injunction." *Anderson v. Jackson*, 556 F.3d 351, 355 (5th Cir. 2009)(citing *Carlucci*, 862 F.2d at 1211).

## SUMMARY OF ARGUMENT

The District Court did not abuse its discretion in denying the Receiver's request for an asset freeze over amounts equal to innocent investors' principal investments in SIB CDs. Specifically, the District Court did not err in finding that the Receiver could not, as a matter of law, establish a likelihood of success on the merits of his claim for principal.

First, courts uniformly hold that Ponzi scheme receivers can not clawback amounts equal to investors' principal investments in a Ponzi scheme. Second, the District Court did not err in denying the Receiver's request because these Seven Investors cannot be proper "relief defendants." They have an undisputable ownership interest in their redemption payments from SIB, received prior to the institution of this Receivership. Accordingly, because these Seven Investors are not proper "relief defendants" the Receiver's claim against them fails.

Third, the precedent relied upon by the Receiver is inapposite. It applies solely to assets within the receivership estate – not assets transferred to innocent investors prior to the institution of the receivership. The Receiver's cited authority does not support, or even contemplate, clawback claims of any nature, let alone

those seeking to clawback the pre-receivership return of principal from innocent investors.

Finally, the Receiver's attempt to position this matter as one of "equity" is unavailing. Equity does not work in favor of the result sought by the Receiver, but rather against his argument. These Seven Investors who maintained accounts with Stanford Financial Group are themselves victims of circumstance. As the Examiner has correctly noted, but for having their accounts at Pershing, none of these alleged "relief defendants" would be subject to the Receiver's claim. USCA5 36 at pg. 12:10-16; RE 41. This Receiver's ability to freeze the accounts of and sue 600 plus alleged "relief defendants" for assets outside the receivership estate is as fortuitous as the timing of these Seven Investors' redemptions of their SIB CDs.

## ARGUMENT

### I. The District Court Did Not Abuse Its Discretion In Concluding That The Receiver Did Not Meet Its Burden and Establish The Elements Necessary To Obtain A Preliminary Injunction.

To obtain a preliminary injunction, the Receiver must show: (1) a substantial likelihood that he will prevail on the merits, (2) a substantial threat that he will suffer irreparable injury if the injunction is not granted, (3) that his threatened injury outweighs the threatened harm to the party whom he seeks to enjoin, *and* (4) that granting the preliminary injunction will not disserve the public

interest. *PCI Transp., Inc.*, 418 F.3d at 545. Here, the Receiver cannot establish one – let alone all – of these elements. The District Court heard extensive argument on these issues and concluded that the Receiver could not meet his high burden of establishing a likelihood of success on the merits or that the threatened injury outweighed the harm to the Seven Investors. Given the facts before the District Court and the relevant precedent, the District Court did not abuse its discretion.

### A. The District Court did not err in concluding that the Receiver cannot establish a likelihood of prevailing on his claims.

Under existing case law, the Receiver is unlikely to prevail on the merits. As such, the District Court did not err in determining that the Receiver could not establish a likelihood of success on the merits.

The Receiver's underlying theory is one of avoidance – that somehow the return of an investor's principal investment amounts to a distribution of "ill-gotten gains" that should be avoided. At its core, despite its novel packaging, the Receiver alleges a fraudulent transfer of property and seeks to avoid that transfer. Applicable law of this and other circuits makes it clear, however, that the Receiver's theory is without merit. The District Court heard argument on these theories and ultimately concluded that the Receiver failed to meet his burden of establishing a likelihood of success on the merits.

According to the Uniform Fraudulent Transfer Act (and the Texas equivalent), when property is transferred to a wholly innocent party who takes the property in good faith and for reasonably equivalent value, that property cannot be subsequently recovered from the innocent party. *SEC v. Resource Dev. Int'l, LLC*, 487 F.3d 295, 302 (5th Cir. 2007); *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006); Tex. Bus. & Comm. Code §24.009(a). In *Resource Dev. Int'l, LLC*, this Court stated that "a defendant may prevent recovery of the transferred assets by proving that the transfers were received in good faith and in exchange for reasonably equivalent value." *Resource Dev. Int'l, LLC*, 487 F.3d at 302.

Moreover, courts uniformly have held that a receiver – similarly situated to the Receiver here – cannot clawback amounts equal to an investor's principal investment that were transferred from the Ponzi scheme prior to the institution of the receivership. *Donnell v. Kowell*, 533 F.3d 762, 770-771 (9th Cir. 2008) (holding the general rule in clawback cases against Ponzi scheme investors is that only amounts in excess of the amount of principal that they originally invested can be recovered); *In re Slatkin*, 525 F.3d 805, 814-815 (9th Cir. 2008) (holding only when a Ponzi scheme investor has made more than their initial investment should they be compelled to return those excess amounts or profits); *Scholes v. Lehman*, 56 F.3d 750, 757 (7th Cir. 1995)(holding that an investor in a Ponzi scheme would only disgorge "the difference between what he put in at the beginning and what he had at the end"); *In*

*re United Energy Corp.*, 944 F.2d 589, 597 (9th Cir. 1991) (holding there has been no fraudulent transfer to a good faith investor where a Ponzi scheme makes payments that total less than that investor's initial investment); *Warfield v. Carnie*, No. 3:04-CV-633-R, 2007 WL 1112591, at *12 (N.D. Tex Apr. 13, 2007) (citing *Scholes* in holding investors in illegal Ponzi schemes provide reasonably equivalent value up to the portion of their actual investment in the scheme; and therefore, those amounts cannot be clawed back by an equity receiver); *Mays v. Lombard*, No. 3:97-CV-1010-X, 1998 WL 386159, at *3 (N.D. Tex. Jul. 2, 1998) (citing *Scholes* in the absence of Fifth Circuit precedent, holding that an investor be required to disgorge only amounts in excess of what investor put into the fraudulent scheme); *In re Bayou Group, LLC*, 372 B.R. 661, 665 (Bankr. S.D.N.Y. 2007) (citing *Scholes* and rejecting fraudulent conveyance claims seeking to recover amounts equal to investors' principal).

Pre-receivership payments to wholly innocent investors are considered repayment of principal up to the point of the initial investment. *Donnell*, 533 F.3d at 771 (citing Mark A. McDermott, *Ponzi Schemes and the Law of Fraudulent and Preferential Transfers*, 72 Am. Bankr. L.J. 157, 168-169 (1998)). The *Donnell* court concluded:

> Amounts transferred by the Ponzi scheme perpetrator to the investor are netted against the initial amounts invested by that individual… If the net is negative, the good faith losing investor is not liable because payments received in amounts less than the initial investment, being

> payments against the good faith losing investor's as-yet unsatisfied restitution claim against the Ponzi scheme perpetrator, are not avoidable under UFTA." 533 F.3d at 771.

This same reasoning squarely applies here: the Seven Investors – wholly innocent by the Receiver's own admission – are entitled to retain initial investments (or principal) because they have provided value – the reduction of their restitution claim against the fraud.

Similarly, In *Scholes v. Lehman*, 56 F.3d 750, 757 (7th Cir. 1995), Judge Posner noted that an investor should be permitted to retain his original principal payment and is only precluded from retaining profits in excess of that original investment. *Id*. The Seventh Circuit, acknowledging an innocent investor's clear right to retain amounts equal to his principal investment in the Ponzi scheme, concluded:

> He should not be permitted to benefit from the fraud at their expense [other investors] merely because he was not himself to blame for the fraud. All he is being asked to do is to return the net profits of his investment – the difference between what he put in at the beginning and what he had at the end." *Scholes*, 56 F.3d at 757.

The Northern District of Texas is in accord. *Warfield v. Carnie*, No. 3:04-CV-633-R, 2007 WL 1112591, at *12 (N.D. Tex Apr. 13, 2007); see also, *Mays v. Lombard*, No. 3:97-CV-1010-X, 1998 WL 386159, at *3 (N.D. Tex. Jul. 2, 1998) (holding that an investor may disgorge amount in excess of what he put into the Ponzi scheme). In *Warfield v. Carnie*, the District Court expressly concluded

that monies returned equal to the original investment amount were considered a return of principal and not profits. *Id.* at *12. Thus, it was only those amounts received that were in excess of the initial investment that could be considered "fictitious profits" and subject to clawback by the receiver. *Id*.[4]

Not only is it well established that innocent investors (such as the Seven Investors) are entitled to retain a return of their original principal investment; but, courts have also held that "false" interest payments are considered the return of principal not "reachable" by receivers. Transfers from a Ponzi scheme disguised as interest payments only constitute "reachable" profits if the amount of interest payments has exceeded the individuals' principal investment. *SEC v. Amerifirst Funding, Inc.*, No. 3:07-CV-1188-D, 2008 WL 919546, at *5-6 (N.D. Tex Mar. 13, 2008)(Fitzwater S.) In *Amerifirst*, Judge Fitzwater held that pre-receivership interest payments were properly treated as the return of principal for purposes of "netting" the investors' status to determine eligibility for and amounts of later pro rata distributions from the receivership estate. *Id.* Facing a situation virtually identical to this Receiver's, the receiver in *Amerifirst* didn't seek to clawback principal or fraudulent interest payments, but rather treated the "interest payments" (presumably made with other investors' money) as a return of each investors'

[4] It is also worth noting that in the somewhat parallel fraud case involving Bernard Madoff, the Liquidator there has made clear that it did not believe that it was entitled to clawback original principal investments. USCA5 30-31; RE 35-36.

principal. *Id*. Thus, returned principal, regardless of how it is characterized by the perpetrator of the scheme or the Receiver, is not subject to clawback unless the amounts of interest payments exceed an investors' principal investment.

Implicit in these precedents are two principles that this Receiver has failed to recognize: (1) that principal returned to innocent investors prior to an equity receivership is not recoverable; and (2) receivers and courts have faced the very circumstances this Receiver now faces and have uniformly permitted innocent investors to retain amounts equal to their principal investment. *Donnell*, 533 F.3d at 776; *In re Slatkin*, 525 F.3d at 814-815; *Scholes v. Lehman*, 56 F.3d at 757; *Warfield v. Carnie*, 2007 WL 1112591, at *12 (N.D. Tex Apr. 13, 2007); *Mays v. Lombard*, 1998 WL 386159, at *3; *In re United Energy Corp.*, 944 F.2d at 597.[5]

In contrast to these precedents, the Receiver is unable to offer this Court any authority supporting the clawback of principal from innocent investors. Moreover, the Receiver has not identified any law demonstrating that the District Court erred in following the existing case law in reaching its conclusions. Rather, the Receiver erroneously relies upon cases discussing pro rata distributions and asserts the District Court failed to exercise its discretion. Appellant's Brief at pg. 16-23. However, the pro rata distribution cases involve the methodology of

[5] It should be noted that the Receiver is aware of this line of cases and their holdings. See SR 1978 – 2011 at 1991-1993. Yet, the Receiver has intentionally avoided this body of case law because he knows that it forecloses his claims to principal: "we're not pursuing statutory fraudulent transfer claims, and for good reason." USCA5 49 at pg. 25:6-7; RE 54.

distributing assets that are properly and indisputably part of the receivership estate – a factual scenario not present here.

Those cases that narrowly focus on mature receiverships where the assets of the estate have already been marshaled, accounted for, and can be distributed have no relevance to the merits of the Receiver's clawback claims against these Seven Investors. *See*, *U.S. v. Durham*, 86 F.3d 70 (5th Cir. 1996); *SEC v. Forex Asset Mngmt., LLC,* 242 F.3d 325 (5th Cir. 2001); *SEC v. Infinity Group Co.*, 226 Fed. Appx. 217 (3d Cir. 2007). Neither *U.S. v. Durham*, 86 F.3d 70 (5th Cir. 1996) nor *SEC v. Forex Asset Mgmt., LLC*, 242 F.3d 325 (5th Cir. 2001) support a clawback of pre-receivership principal from wholly innocent investors. As a threshold matter, *Durham* and *Forex* address an issue that this Receiver does not yet face – whether an estate's assets (after being marshaled) should be distributed pro rata to all victims or whether the estate's assets clearly traceable to a single victim should be returned solely to that individual.[6]

The Receiver's claim that *Forex* is "analytically indistinguishable" from the instant matter is, at best, misleading. A factual scenario that is analytically

[6] Perhaps the Receiver doth protest too much when he states that "*Durham* cannot be distinguished from this case on the mere fact that Claremont's deposit had not yet been returned to it, whereas relief defendants cashed out shortly before the scheme collapsed." Appellant's Brief at pg. 19. That is exactly why *Durham* – and likewise *Forex* – are distinguishable. In *Durham*, had Claremont's $70,000 been returned to Claremont's own account rather than remaining in the frozen account of Cypress, Ltd. at Pavilion National Bank, Claremont's $70,000 would not have been frozen and the United States would have had to file a fraudulent transfer action (or some other cause of action) to reclaim those funds.

indistinguishable to *Forex*[7] is not the issue pending before this Court. The Receiver's implied contention that a segregated trading account in *Forex* – that was owned and controlled by the perpetrator of the fraud – is akin to these Seven Investors' segregated custodial accounts at Pershing – the contents of which are one hundred percent owned and held in the names of the investors[8] – is, to say the least, completely at odds with the facts. The accounts at Pershing are held in the names of (and for the benefit of) customers (these Seven Investors) and there can be no question that the Receiver does not own or have an ownership interest in the contents of those accounts.

*Forex* actually cuts against the Receiver's clawback claims. The *Forex* appeal was strictly limited to the receiver's distribution of estate assets, not clawback claims for early redemption payments. *Forex*, 242 F.2d at 328. Indeed, forty-five of the eighty-seven investors identified by the Receiver in *Forex* had their investments returned and yet were never sued by the receiver. *Id*. at 328, n. 3.

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[7] An indistinguishable factual and analytical scenario would be the case of an investor tracing his funds to a "special CD" program created for him by Allen Stanford, and that investor arguing he is entitled to a distribution from the receivership estate equal to the entirety of his investment because his money is segregated from other investors' money and can be traced. Clearly, this is not the issue pending before this Court, and *Forex* is inapplicable to this Receiver's claims.

[8] *See e.g.*, Fully Disclosed Clearing Agreement with Pershing, LLC SR 0307 – 0340 (providing "Pershing shall carry the proprietary accounts of Broker [Stanford] and the cash and margin accounts of the customers of Broker")(emphasis added); Agreement for Securities Clearance Services with Bear Stearns SR 0341 – 0355 (providing "Bear Stearns Securities will carry such of your customer accounts as will be mutually agreed by the parties hereto: These accounts are hereinafter called "Accounts" and legal and beneficial owners thereof are hereinafter called the "Customers.")

*Forex*, like *Infinity* and *Durham*, does not support the Receiver's clawback claims, and, in fact, amplifies the Receiver's misplaced reliance on this line of cases.[9]

The filing of this clawback action is persuasive evidence that the Seven Investors' Pershing accounts are not assets of the Receivership Estate. Accordingly, this Receiver faces an entirely different factual scenario from those contemplated in *Durham*, *Infinity* and *Forex*. The mere fact that accounts are frozen (contrary to applicable law)[10] does not, by itself, make the accounts part of the Receivership Estate. Thus, the mere fact that the Receiver managed to obtain an improper freeze over investors accounts is inconsequential to this Court's determination of the Receiver's likelihood of success on the merits of his clawback claims.

[9] It is axiomatic to this point that the Receiver also argues that *SEC v. Infinity Group Co.* supports his clawback claims against innocent investors. *Infinity*, like *Durham* and *Forex*, merely stands for the unremarkable proposition that a circuit court defers to the discretion of the lower court in choosing between "tracing" and "pro rata" distribution. *SEC v. Infinity Group Co.*, 226 Fed. Appx. 217, 219 (3d Cir. 2007). In drawing an analogy between the investor in *Infinity*, who made an investment just before the receivership was initiated, and these Seven Investors, the Receiver overreaches. The Appellant in *Infinity* had invested only days before the institution of the receivership. *Infinity Group Co.*, 226 Fed. Appx. at *2. Here, the Seven Investors redeemed their investments in SIB long before the institution of the Receivership.

[10] See generally, USCA5 1962-1964. Courts evaluating the propriety of freezing customer accounts in connection with SEC instigated receiverships have found that it is improper to freeze assets that belong to innocent investors. *SEC v. Black*, 163 F.3d 188, 196-198 (3d Cir. 1998) (a District Court may only freeze the accounts of investors where (i) the funds in the account belong to a defendant in the pending lawsuit, or (ii) the investor is a "wrongdoer" as described in 15 U.S.C. §78 (d) and (e)); *SEC v. Cherif*, 933 F.2d 403, 413 (7th Cir 1991) (there is no case law that suggests that 15 U.S.C. §78u(d) or (e) authorizes a court to freeze the assets of a non-party, one against whom no wrongdoing is alleged).

Finally, the Receiver's entire "constructive trust" theory is without merit. See USCA5 57; RE 62. The Receiver alleges that he should hold the Seven Investors' redeemed principal and interest "pursuant to a constructive trust for the benefit of the Receivership estate." USCA5 57; RE 62. The Receiver's argument ignores the Restatement of Restitution and longstanding principles of law established by the decisions of nearly every court. A person who receives property for value and without notice of wrongdoing becomes a "bona fide purchaser" who takes good title to that property even if it otherwise would be subject to a constructive trust. E.g., *Restatement of the Law – Restitution* § 172; *E.D. Sys. Corp. v. Southwestern Bell Tel. Co.*, 674 F.2d 453, 459 (5th Cir. 1982) (Texas law); *Fairfield Fin. Mortgage Group v. Luca*, 584 F. Supp.2d 479, 486 (New York law); *Stith v. Thorne*, 488 F. Supp.2d 534, 547-58 (E.D. Va. 2007) (Virginia law).

Here, the indisputable facts are that the Seven Investors (as well as the other "relief defendants") gave value to SIB in the form of the purchase of the CDs for cash. They did so pursuant to the provisions of the SIB CD contract and in return for the Bank's promise to repay the principal plus an agreed rate of interest. Given that it is also undisputed that the Seven Investors engaged in this transaction innocently and without notice of any fraud at SIB, the Receiver cannot state a claim for imposition of a constructive trust. Accordingly, because the Seven Investors took their SIB CD principal redemptions in good faith and for reasonably

equivalent value, the Receiver is not entitled to a constructive trust, and his clawback claims fail as a matter of law.

### B. The Receiver failed to meet his burden in establishing the other mandatory elements to obtain a preliminary injunction.

In addition to failing to establish a likelihood of success on the merits, the Receiver also failed to meet his burden of establishing any of the other three elements required to obtain a preliminary injunction.

*First*, the Receiver failed to establish a threat of irreparable harm. Although the Receiver made the unsupported allegation that the mere release of Appellees' accounts will cause a dissipation of assets, he did not provide any evidence to that effect. USCA5 52-53, pg. 28:25-29:4; RE 57-58. To the contrary, the District Court specifically considered arguments that demonstrated that the assets may remain available even if they were unfrozen. USCA5 67-68, pg. 43:17-44:7; RE 72-73. Moreover, there is no basis, evidentiary or otherwise, for this Court to determine that assets might "wander" so far the Receiver could not satisfy a judgment should he prevail on his claims. Even if the Receiver could establish an inconvenience in collecting a judgment, this falls far short of irreparable harm. *Miss. Power & Light Co. v. United Gas Pipe Line Co.*, 760 F.2d 618, 629 (5th Cir. 1985) ("the hardship and inconvenience attendant on interim loss of monies which will be paid, with interest, on final judgment does not constitute irreparable harm").

*Second*, the Receiver certainly cannot show that the District Court erred in concluding that the potential harm to the Receiver did not outweigh the harm to the Seven Investors. Notwithstanding that it was their investment and their money, the Receiver oddly and mistakenly contends that the Seven Investors cannot be harmed because they do not have an ownership interest in this money. The District Court already recognized the investors' hardship, and certainly did not abuse its discretion in doing so. SR 2042-2043; RE 103-104. The District Court recognized the hardship in its Order dated June 29, 2009, when it stated:

> The Receiver has estimated that he needs an additional ten weeks to complete his review of accounts. *In view of the hardship the freeze is causing the individual investors*, the Court cannot leave the freeze in place that long. SR 2042-2043; RE 103-104 (emphasis added).

Moreover, nowhere in the record below does the District Court ever change that view. Given the District Court's clear statement, it is hard to imagine that Appellant is correct in asserting that "the balance of equities lies heavily in favor of extending the status quo." Appellant's Brief at pg. 34.

To the contrary, if the District Court granted the freeze it would actually change the status quo. The alleged "relief defendants" had the right to collect and use the full amount of their principal on August 13, 2009 pursuant to the District Court's Order. *Id.* The Receiver, however, asks this Court to revert back to the status he enjoyed before the District Court's Order when Appellees' principal and interest remained frozen indefinitely. Continuing to deny innocent investors

access to their own money substantially harms the alleged "relief defendants." The Receiver has already denied them access to those funds for more than six months based on claims that are meritless according to the SEC, the Examiner, and the District Court. *See, e.g., Connecticut v. Doehr,* 501 U.S. 1, 17, (1991) (taking notice of inherent and severe hardship caused by pre-judgment attachment).

*Third,* the Receiver failed to meet his burden of proof and demonstrate that the requested injunction is in the public interest. The Receiver's clawback claims focus on a small subset of investors that will conceivably fund the Receiver's distributions to other SIB investors who despite receiving SIB distributions will never be subject to the Receiver's clawback claims. USCA5 35; RE 40. There are approximately 28,000 investor-victims of the fraud. Of those, only about 4,500 are in the United States. *Id.* The Receiver is asserting claims against only 650 investors who happen to have frozen accounts at JPMorgan and Pershing. *Id.* The public interest is not served by the Receiver's clawing back redemption payments from a narrow group of investor-victims to redistribute those assets to all victims.

The public interest is better served by a proper and reliable application of the law. To indulge the Receiver's legal gymnastics is not in the public's interest. The Receiver has intentionally disregarded the fully developed controlling body of case law. This Court should not permit the creation of a cause of action (or claim to principal) where none legally exists.

## II. The Seven Investors Are Not Proper "Relief Defendants," And Therefore, Receiver's Clawback Claims Fail As A Matter of Law.

Even if the Receiver could meet his burden and establish all four elements of the requested preliminary injunction – which he cannot, and which the District Court specifically found he did not – the Receiver cannot sue *these* wholly innocent investors under a "relief defendant" theory. First, innocent CD investors targeted by the Receiver are simply not proper "relief defendants" because each such investor has a legitimate claim to, and an obvious ownership interest in, the funds at issue. Second, the Receiver lacks standing to unilaterally name "relief defendants" and bring such clawback claims against innocent investors. Third, the cases cited by the Receiver are incongruent with the facts of this case, and thus, are of little value in establishing the merits of his claim.[11]

### A. These Seven Investors are not proper "relief defendants" because they have clear ownership interests in their own accounts.

Even if the Receiver could properly name "relief defendants" without the SEC, the Seven Investors certainly do not qualify. To be a proper "relief

[11] Provided that a district court's order is properly before the Court of Appeals, this Court may affirm that order on any grounds, not simply those provided in the order. *Ducre v. Exec. Officers of Halter Marine, Inc.*, 752 F.2d 976, 983 n. 16 (5th Cir. 1985) (holding that the appellate court may address all issues material to the order and is not limited to consideration of the controlling question). In other words, "[o]nce a case is lawfully before a court of appeals, it does not lack power to do what plainly ought to be done." *Mercury Motor Exp., Inc. v. Brinke*, 475 F.2d 1086, 1091 (5th Cir. 1973). Here, the District Court's Order should be affirmed on multiple grounds, including those explicitly set forth in the District Court's Order as well as those not spelled out in detail.

defendant," an investor must not have an ownership interest in the property at issue. *SEC v. Cherif*, 933 F.2d 403, 414 (7th Cir. 1991). A "nominal" or "relief" defendant is a person who can be joined to aid the recovery of relief without an assertion of subject matter jurisdiction only because he has no ownership interest in the property which is the subject of litigation. *Id*. A nominal defendant holds the subject matter of the litigation "in a subordinate possessory capacity as to which there is no dispute." *Id*. Rather, his relation to the suit is merely incidental and "it is of no moment to him whether the one or the other side in the controversy succeeds." *Id*. The paradigmatic nominal or relief defendant is "a trustee, agent or depository . . . who is joined purely as a means of facilitating collection." *Cherif*, 933 F.2d at 414.[12] These Seven Investors, however, are not paradigmatic relief defendants. Rather, they have a clear ownership interest in the property and correspondingly a significant interest in subject matter of this litigation.

The threshold for determining if an alleged relief defendant has a legitimate ownership interest in disputed property is not particularly high. Indeed, courts faced with determining whether an alleged relief defendant has a legitimate ownership interest in accounts have even recognized the possible interests of

[12] This Court, albeit while describing nominal defendants in the context removal, has held that "a party is nominal if its role is restricted to that of 'depository or stakeholder.'" *In re Beazley Ins. Co.*, No. 09-20005, 2009 WL 205859, at *4 (5th Cir. 2009) (citing *Louisiana v. Union Oil Co. of Cal.*, 458 F.3d 364, 366-367 (5th Cir. 2006).

potential wrongdoers. *Cherif*, 933 F.2d at 415; *SEC v. Ross*, 504 F.3d 1130, 1142 (9th Cir. 2009).

In *Cherif*, the Seventh Circuit refused to reject an alleged relief defendant's ownership interest in his accounts despite evidence that Cherif used those very accounts to perpetrate the alleged fraud. *Cherif*, 933 F.2d at 415 (holding we can not deem the nature of Sanchou's interest in the funds in his accounts to be so subordinate that treatment of Sanchou as a relief defendant is justified). Likewise in *SEC v. Ross*, the Ninth Circuit recognized an alleged relief defendant's legitimate interest in commission payments he received for promoting a fraudulent scheme. *SEC v. Ross*, 504 F.3d at 1142 (holding it is one thing to argue that custodian or trustee has no legitimate claim to assets improperly or fraudulently conveyed to her; it is quite another to assert a relief defendant has no legitimate claim to commissions received – even if received for promoting the fraud).

If individuals can have "legitimate ownership interests" in accounts used to perpetrate a fraud and commissions earned promoting a fraudulent scheme, then without question purely innocent investors have the requisite "legitimate ownership interest" in funds held in their own accounts that represent the return of amounts they principally invested. *Cherif*, 933 F.2d at 415; *Picard Chem. Inc. Profit Sharing Plan v. Perrigo Co.*, 940 F. Supp. 1101, 1136 (W.D. Mich. 1996) (holding because alleged nominal defendants have interests in stock in question,

the so-called nominal defendants are therefore not disinterested parties who hold the stock in trust for the primary wrongdoers as is required by *Cherif*); *CFTC v. Sarvey*, No. 08-C-192, 2008 WL 2788538, at *4 (N.D. Ill. 2008)(concluding alleged relief defendant had an interest in the subject matter of litigation and was not a proper relief defendant); *CFTC v. Hanover Trading Corp*., 34 F. Supp.2d 203 (S.D.N.Y. 1999) (finding a legitimate ownership interest in commissions received from the fraud for promoting the fraudulent scheme).

Judge Kaplan's discussion of the origin and limits of the expansive power claimed by the Receiver in *CFTC v. Hanover Trading Corp*., 34 F. Supp.2d 203 (S.D.N.Y. 1999) is instructive. There, the CFTC sought disgorgement or a constructive trust on 48 checks the defendant received as commissions on sales allegedly in violation of the Commodities Exchange Act. *Hanover*, 34 F. Supp.2d at 205. The district court found that the sales transactions were no more than voidable, and not void, and that the commissions could be recovered only on a showing of actual knowledge of the fraud by the defendant. *Id*. at 206 (citing *SEC v. Levine*, 881 F.2d 1165, 1176-78 (2d Cir. 1989)).

The Court also rejected the CFTC's effort to impose a constructive trust on the commissions at issue:

> It is often said that 'disgorgement does not penalize, but merely deprives wrongdoers of ill-gotten gains.' In ordinary circumstances, there is no basis for disgorgement by an innocent party. . . . To be sure, it is well established under the

> securities and, by analogy, the commodities laws that district courts, at the behest of the SEC and CFTC, respectively, in appropriate cases may reach funds held by non-parties. But that power is not entirely boundless.
>
> In *Deckert v. Independence Shares Corp*., 311 U.S. 282, 61 S.Ct. 229, 85 L.Ed.2d 189 (1940), the wellspring of this authority, the Supreme Court in relevant part merely held sufficient a bill in equity seeking restitution from a relief defendant of funds held by the relief defendant "for account of [the principal defendant], which consisted in part of the payments alleged to have been procured by the fraud of" the principal defendant. Thus the bill did not seek recovery of funds to which the relief defendant had a claim of entitlement in his own right. Subsequent cases have extended *Deckert* to permit recovery from relief defendants, irrespective of their culpability, who possess illegally obtained profits and have no legitimate claim to them. . . .
>
> Each of these cases focused on the relief defendant's lack of a legitimate claim to the money sought, whether because the relief defendant was a gratuitous beneficiary of the principal defendants' fraud or because he or she merely was the custodian of the principal defendants' assets. . . In other cases in which relief defendants claimed to have earned the money sought, courts have permitted seizure or required disgorgement only after determining that the relief defendant in fact had no legitimate claim to the money. *Id*. (citiations ommitted).

Similarly here, where the Receiver does not allege any wrongdoing by these Seven Investors, and does not claim they hold accounts for the Stanford defendants or that they are the recipient of some gratuitous transfer from the alleged wrongdoers, there is no basis as a matter of law to name them as relief defendants.

Most recently, the Middle District of Florida held that Sun Capital (the recipient of loan proceeds from a fraudulent scheme) had a legitimate ownership

interest in funds received from fraudulent scheme pursuant to a note. *SEC v. Founding Partners Capital Mgmt.*, No. 2:09-cv-229-FtM-29SPC, 2009 WL 1606491 at *3 (M.D. Fla. 2009); See also *SEC v. Sun Capital, Inc*., No. 209-cv-229-FtM-29SPC 2009 WL 1362634 at *2 (M.D. Fla. 2009) (SEC could not impose freeze on assets of person with legitimate claim to funds, who therefore was not proper relief defendant). The SEC alleged that the principal defendants made loans to Sun Capital pursuant to written loan agreements but sought relief from Sun Capital solely as a relief defendant.

The district court found that the SEC had failed to meet the requirement of alleging that Sun Capital lacked an ownership interest or legitimate claim to the loaned funds and granted Sun Capital's motion to dismiss.

> The case law only requires an "ownership interest" or "legitimate claim" in the funds to preclude an entity from being a proper relief defendant. This does not require possession of the full bundle of ownership rights that may exist in various types of property. It is undisputed that Sun Capital received the loan proceeds pursuant to written loan agreements with Stable-Value, which gives Sun Capital certain rights and obligations with respect to the loan proceeds. There has been a debtor-creditor relationship between Sun Capital and Stable-Value since 2001. That constitutes a sufficient legitimate ownership interest to preclude treating Sun Capital as a relief defendant.
>
> Sun Capital is a far cry from the "paradigmatic" nominal defendant: a trustee, nominee, or depository. The Complaint affirmatively alleges facts showing that Sun Capital has a legitimate ownership interest and/or a legitimate claim to the loan proceeds. This precludes Sun Capital from being a proper relief defendant even if, as the SEC argues, its claim is

> subordinate to the ownership claims of investors. *Id*. (citations omitted).

Here, the Receiver mistakenly alleges that the Seven Investors, who are innocent investors, have no ownership interest in funds returned to them pursuant to their CD contracts with SIB.

> The provisions of a certificate of deposit form a contract which creates the relationship of debtor and creditor between the bank and its depositor. Such contract determines the manner in which the funds of the depositor may be withdrawn and is subject to the laws of contract.

*Ames v. Great Southern Bank*, 672 S.W.2d 447, 449 (Tex 1984) (citations omitted); see also, *Centennial Sav. Bank FSB v. U.S.*, 887 F.2d 595, 605 (5th Cir. 1989) (holding CD penalty provision part of initial CD contract giving rise to debtor/creditor relationship). Moreover, under Texas law, certificates of deposits are merely savings accounts. *Cushman v. Resolution Trust Co.*, 954 F.2d 317, 324, n. 11 (5th Cir. 1992). These Seven Investors have a contractual ownership interest in their redemption payments from SIB just as Sun Capital did in the loan proceeds it received pursuant to a written loan agreement. *Founding Partners*, 2009 WL 1606491, at *3. Likewise, under Texas law, these Seven Investors also have a legitimate and recognizable ownership interests in funds that were invested in SIB that are akin to their own savings accounts.

The Receiver wrongly dismisses the Seven Investors' ownership interests by noting that their contractual rights to redemption payments are no different than

contractual claims of the investors who did not, or were unable to, redeem their CDs from SIB. Appellant's Brief at pg. 28. However, the test to determine if these Seven Investors are proper relief defendants is simply whether or not they have legitimate ownership interest in the funds they received from SIB – they do. The mere fact that every Stanford investor has the same contractual rights, and therefore no Stanford investors could be a proper relief defendant is of no consequence to the analysis. These Seven Investors received redemption payments from SIB pursuant to their contractual rights, meaning their legitimate ownership interest in their redemption payments is incontrovertible.

Notwithstanding this precedent and analysis, the Receiver's string cite of authority supporting disgorgement from relief defendants is inapposite because not one of the cases concerns investors with such legitimate ownership interests.[13]

[13] A close read of each of the Appellant's cited cases makes clear that the investors at issue in each case did not have ownership interests akin to the Seven Investors here. See *SEC v. Colello*, 139 F.3d 674 (9th Cir. 1998) (affirming disgorgement against a relief defendant who claimed to have received compensation for services rendered to the defrauding company); *CFTC v. Kimberlynn Creek Ranch*, 276 F.3d 187 (4th Cir. 2002) (affirming asset freeze against relief defendants who were simply holding funds on behalf of the alleged violators and rejecting their unsupported assertion that they received compensation for services rendered); *SEC v. Elfindepan, S.A.*, No. 1:00CV0742, 2002 WL 31165146 at *6-7 (M.D.N.C. Aug. 30, 2002) (involving relief defendants who obtained funds by defrauding the named defendants); *SEC v. Cavanagh*, 155 F.3d 129 (2d Cir. 1998) (affirming asset freeze against relief defendant who was alleged violator's wife where husband transferred assets to her without her knowledge); *SEC v. Egan*, 856 F. Supp. 401 (N.D. Ill. 1993) (allowing disgorgement claims against relief defendants that were limited partners in the named defendant and received allegedly tainted partnership receivables); *SEC v. AmeriFirst Funding, Inc*., 2008 WL 1959843 at *6-7 (N.D. Tex. May 5, 2008) (ordering disgorgement against a relief defendant who received defrauded investors' money from the principal defendants in the form of consulting fees for services in furtherance of the fraud).

Likewise, the Receiver's reliance on *SEC v. George*, 426 F.3d 786 (6th Cir. 2005) as a basis to deny the Seven Investors their legitimate ownership interest is misplaced and inapplicable to this case.

As a preliminary matter, it is worth noting that the SEC – the party that sought this Receiver's appointment and the very plaintiff in *George* – has made clear that *George* does not apply in this case. SR 2077-2078; RE 85-86. Prior to the Receiver filing his clawback claims, the SEC informed the Receiver of the clear factual differences between *George* and the case at bar. SR 2078; RE 86 (The Receiver was fully apprised of the special circumstances in *George*, and nonetheless, he has ignored those circumstances and had repeatedly cited the case as his most significant authority).

In *George* the SEC, not an equity receiver, asserted claims against relief defendants who happened to be investors. *George*, 426 F.3d at 788. However, the threshold fact of *George* is that the investors named as relief defendants were not innocent. SR 2077; RE 85. Rather, the SEC pursued each of the *George* relief defendants because each of them had dirty hands in one way or another. *Id.*[14] In

[14] Specifically, in *George*, Dziorny, was the girlfriend of the perpetrator of the fraudulent scheme, was not an investor, and received multiple gifts paid for with the proceeds of the fraud. SR 2077; RE 85. According to the SEC, George not only received twice as much money as he principally invested in the scheme, but he also assisted the primary defendant in funneling money away from the asset freeze. *Id.* Likewise, both Jackson and Harris, investors and promoters of the fraudulent scheme, schemed to violate the terms of the asset freeze to recover their principal and interest after already receiving substantial distributions from the fraud. SR

the face of these undisputable distinguishing facts, *George* lends no support to the Receiver's clawback of principal from admittedly innocent investors.

### B. The Receiver can not unilaterally name "relief defendants."

Even if the Court concludes that the Seven Investors did not have an ownership interest in their own principal investment in SIB and thus could be considered "relief defendants," the Receiver lacks the authority to designate anyone as a "relief defendant."

The Receiver cannot point to any authority supporting a receiver's ability to unilaterally name and sue "relief defendants" to obtain estate assets. That authority lies solely with the SEC. The underlying policy is sound. The SEC – the federal agency entrusted with bringing securities enforcement actions – is best suited to make the determination as to both proper defendants and proper relief defendants who may have received proceeds from a fraudulent scheme. Only once the SEC has identified relief defendants (by adding them as parties to a securities enforcement action) can a receiver step in and sue such relief defendants. *See, e.g.*, *SEC v. Cavanagh*, 155 F.3d 129, 136 (2nd Cir. 1998) (federal courts may order equitable relief against a person who is not accused of wrongdoing *in a securities enforcement action*) (emphasis added); *SEC v. Collelo*, 139 F.3d 674, 675-676 (9th Cir. 1998)(two District Courts have *allowed the SEC* to sue a "nominal defendant"

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2077-2078; RE 85-86. The disgorgement against Jackson and Harris was necessary to prevent a windfall, and distinguishable because their actions made them less than innocent investors. *Id.*

to recover fraud proceeds) (emphasis added); *SEC v. Cherif*, 933 F.2d 403, 413-414 (7th Cir. 1991) (SEC seeking remedy from nominal defendant).

All the precedent discussing "relief defendants" and seeking disgorgement from relief defendants concerns actions brought *by the SEC* against relief defendants named as such in the underlying enforcement action. *See*, *Cavanagh*, 155 F.3d at 136; *Collelo*, 139 F.3d at 675-76; *Cherif*, 933 F.2d at 413-14.[15] Here, the Receiver unilaterally named the alleged "relief defendants" in direct contravention of the SEC's position. SR 2073-2080; RE 81-88. This action is unprecedented, the Receiver lacked the authority to unilaterally designate "relief defendants," and, for this reason also, this Court should affirm the District Court's Order.

## CONCLUSION

For all the reasons set forth above, the District Court's Order should be affirmed.

[15] A comprehensive search failed to reveal a single case authorizing an equity receiver to unilaterally name and sue relief defendants. In each and every case, the SEC was the party to make such a designation.

Dated September 30, 2009

**Respectfully Submitted,**

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1. This Brief complies with the type-volume limitation of Fed.R.App.P. 32(a)(7)(B) because this brief contains 12,029 words, excluding parts of the brief exempted by Fed.R.App.P. 32(a)(7)(B)(iii).

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