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; JAY STUART BELL; GREGORY ALAN MADDUX; DAVID JONATHAN DREW; ANDRUW RUDOLF BERNARDO JONES; CARLOS FELIPE PENA; JOHNNY DAVID DAMON; BERNABE WILLIAMS; 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. MARQUETT; 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,

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. No. 3:09-CV-0724-N

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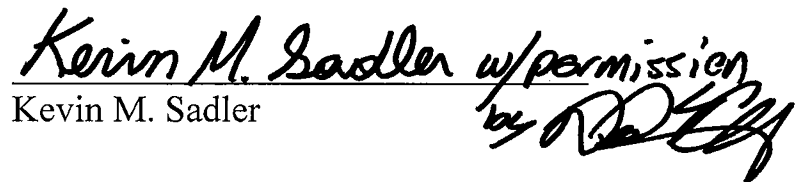

Kevin M. Sadler

STATEMENT REGARDING ORAL ARGUMENT

Oral Argument will crystallize the parties' positions and assist this Court in establishing the rule of law that will govern claims in this Circuit for recovery and distribution of money stolen pursuant to a Ponzi scheme. The Receiver contends that all obtainable funds belong to the Receivership Estate for distribution to all fraud victims pro rata. Thus, the Receiver maintains that an investor who cashed out one week before the receivership should recover the same percentage of his investment as an investor who attempted to cash out one week after the receivership. But the Appellees argue that investors who cashed out before the receivership should recover 100% of their investment — even though they were paid with money stolen from other investors — while those who attempted to cash out later should divide the scheme's meager leftovers. Oral argument will assist the Court in determining which of these rules is more consistent with precedent in analogous cases and with equitable principles that govern receiverships such as this.

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Statement of Jurisdiction

I. Asserted Bases for District Court Subject Matter Jurisdiction

The underlying case is ancillary to a securities fraud case filed by the SEC against numerous Stanford defendants, *SEC v. Stanford Int'l Bank, Ltd.,* No. 3-09-CV-0298-N, in the United States District Court for the Northern District of Texas. Jurisdiction is based on 15 U.S.C., sections 77v(a) and 78aa and also on 28 U.S.C., section 754.

II. Basis for Court of Appeals's Jurisdiction

This is an appeal from the denial in part of a preliminary injunction pursuant to 28 U.S.C., section 1292(a)(1).

III. Filing Dates Establishing Timeliness of Appeal

The district court signed the challenged order on August 4, 2009. R. 477-79. The Receiver filed his notice of appeal on August 6, 2009. R. 480-81.

Statement of the Issues

1. Does the Receiver for a Ponzi scheme have a viable claim for disgorgement of money paid to some investors before the scheme collapsed when (i) the money purports to be return of the investors' principal, but (ii) the money was, in fact, stolen from other investors?

2. Which of the following rules of distribution will the Court adopt to govern this and future Ponzi-scheme receiverships in this Circuit?

(A) A pro rata rule, which seeks to return to each investor the same percentage of his or her investment in the Ponzi scheme; or

(B) A first-come, first-serve rule, which allows investors who cash out shortly before court intervention to recover 100% of their investments while those who attempt to cash out a few days later receive virtually nothing?

STATEMENT OF THE CASE

This case is ancillary to an equity receivership arising out of a multi-billion dollar fraudulent investment scheme. The district court authorized the Receiver to freeze over 30,000 investor accounts while financial professionals determined whether the accounts contain proceeds of the fraudulent activity. Once these reviews were complete, the Receiver named several hundred investors as relief defendants, seeking disgorgement of Ponzi-scheme proceeds that were stolen from thousands of other investors and paid to the relief defendants under the guise of returned principal plus interest.

The Receiver requested a preliminary injunction that would effectively maintain the existing freeze over the relief defendants' Stanford investment accounts until the Receiver's claims for disgorgement are adjudicated. On July 31, 2009, the district court determined that, as a matter of law, the Receiver has no claim against the relief defendants for disgorgement of stolen

money they received as purported return of their invested principal. Based on this determination, the district court denied most of the Receiver's application for a preliminary injunction. In particular, the district court issued an injunction that freezes the relief defendants' accounts only to the extent of purported interest paid to them above the amounts of their principal investments.

The district court stayed the effect of its ruling for ten days to allow the Receiver to request relief from this Court before the relief defendants could disperse the funds in question. On August 9, 2009, this Court granted the Receiver's Motion to Extend Injunction, imposing an account freeze on both principal and interest while it decides this appeal.

STATEMENT OF RELEVANT FACTS

I. The Stanford companies and their too-good-to-be-true CDs

This appeal involves pure questions of law. The following undisputed facts are of record. In addition, most of these facts have been confirmed by Stanford's Chief Financial Officer, James Davis, who has pleaded guilty to his role in running the Stanford Ponzi scheme. A copy of the plea agreement is attached as Appendix B, and the Receiver requests that this Court take judicial notice of the facts recited in it. *See, e.g., Scholes v. Lehman*, 56 F.3d 750, 762 (7th Cir. 1995) (fraudulent conveyance case approving judicial notice of facts in defendant's plea agreement); *In re Fin. Federated Title & Trust, Inc.*, 347 F.3d 880, 883 n.2, 892

(11th Cir. 2003) (affirming equitable lien against property purchased with fraudulently obtained funds and noting that lower court took judicial notice of plea agreement of one of the conspirators).

The Stanford companies ("Stanford") were a sprawling web of more than 130 entities across 14 countries, all controlled by Allen Stanford. R. 298, 302. Although the companies offered a full range of brokerage and investment services, their core objective was to sell certificates of deposit ("CDs") issued by Stanford International Bank Limited in Antigua (the "Bank"). *Id.* The companies achieved this objective by promising above-market returns on the CDs and falsely assuring investors that the CDs were backed by safe, liquid investments. R. 298, 303; Case no. 3:09-cv-298-N, Doc. 1 at ¶¶ 2, 3, 8.[1]

The Bank was nothing like a typical commercial bank. It did not offer checking accounts and did not, in the normal course, make loans. R. 302. It had one principal product line — certificates of deposit — and one principal source of revenue — investor purchases of CDs. R. 298, 302. Substantially all of the funds funneled into each of the Bank's operating and money-market accounts were proceeds from the sale of Bank CDs. R. 298, 307-08. These same accounts were

[1] This Court granted motions by both the appellant and appellees to supplement the record with documents from related cases pending in the same the district court. However, the supplemental record has not yet been certified. This brief will cite to documents to be included in the supplemental record by their Docket Number in the district court.

then the source of CD proceeds paid out to customers, such as the relief defendants, who redeemed their CDs before court intervention. R. 298, 308.

For almost 15 years, the Bank represented that it consistently earned high returns on its investment of CD purchases, ranging from 12.7% in 2007 to 13.93% in 1994. Case no. 3:09-cv-298-N, Doc. 12-36 at 345; Doc. 13-9, SEC App. 670; Doc. 13-49 at 1030. Since 1994, the Bank claimed that it never failed to hit targeted investment returns in excess of 10%. Case no. 3:09-cv-298-N, Doc. 12-42 at 407. The Bank claimed that its diversified portfolio of investments lost only $110 million or 1.3% in 2008. Case no. 3:09-cv-298-N, Doc. 12-56 at 540-41. During the same period the S&P 500 lost 39% and the Dow Jones STOXX Europe 500 Fund lost 41%. *Id.*

The Bank offered significantly higher rates on its CDs than conventional banks and disproportionately large commissions to Stanford financial advisors who sold CDs. Case no. 3:09-cv-298-N, Doc. 12-55 at 531, 533; Doc. 13-9 at 669. On November 28, 2008 the Bank quoted a rate of 5.375% on a 3-year flex CD, while comparable U.S. banks' CDs paid under 3.2%. Case no. 3:09-cv-298-N, Doc. 12-56 at 541. The Bank paid a 1% commission to Stanford financial advisors on the sale of each CD. Case no. 3:09-cv-298-N, Doc. 13-9 at 669.

In its 2007 annual report, the Bank represented that its portfolio was allocated in the following manner: 58.6% equity, 18.6% fixed income, 7.2%

precious metals and 15.6% alternative investments. Case no. 3:09-cv-298-N, Doc. 13-32 at 871. In fact, approximately 80% of the Bank's investment portfolio, the so-called Tier III portfolio, was in unknown assets under the apparent control of Allen Stanford and James Davis. Case no. 3:09-cv-298-N, Doc. 12-4 at 31, 586. And purported "earnings" on Bank investments were actually fabricated monthly by Jim Davis and persons working at his direction and under his supervision. App. B at 12-15. The earnings figures were pegged at whatever amount was needed to give the Bank acceptable financial performance and capital ratios for regulatory purposes. App. B at 14-15. In other words, earnings — at least for the last three years and probably longer — were fictitious "plugged" numbers. *Id.*

The forensic analysis of cash flows for 2008 through February 17, 2009 indicates that funds from sales of new Bank CDs were used to make purported interest and redemption payments on pre-existing CDs. R. 298, 303-04, 314-15. The Bank had to use CD sale proceeds for these redemptions because it did not have sufficient assets, reserves and investments to cover the liabilities for redemptions and interest payments. R. 303-04. "Although [the Bank] received some returns on investments, these amounts were miniscule in comparison to the obligations." R. 298, 304. In other words, the Bank operated as a massive Ponzi scheme. *See* BLACK'S LAW DICTIONARY 975 (abridged 8th ed. 2005) (defining a Ponzi scheme as "[a] fraudulent investment scheme in which money contributed by

later investors generates artificially high dividends or returns for the original investors").

At the inception of the Receivership on February 16, 2009, the total principal amount of outstanding Bank CDs was approximately $7.2 billion (U.S.), according to Bank records. R. 298, 303. This $7.2 billion reflects a liability on the books of the Bank, as it is owed to the investors. *Id.* Although the Bank financial statements reflect investments valued at $8.3 billion (classified as assets) as of December 31, 2008, the combined assets of all Stanford Entities (the Bank included) actually have a total value of less than $1 billion. *Id.* The Bank is insolvent and apparently has been for a considerable time. *Id.* The billions of dollars bilked from Bank CD investors paid for lavish Stanford offices, an ultra-luxurious lifestyle for Stanford principals and their families, a fleet of aircraft, political contributions, athletic sponsorships, speculative "investments," and the list goes on.

II. The lawsuit and preliminary orders

The SEC filed suit against Allen Stanford, the Bank, and other Stanford companies on February 16, 2009. Case no. 3:09-cv-298-N, Doc. 1. At the SEC's request, the district court issued a temporary restraining order. Case no. 3:09-cv-298-N, Doc. 8. Among other things, this order restrained the defendants and anyone in "active concert or participation with them" from "making any

payment or expenditure of funds belonging to or in the possession, custody, or control of Defendants." *Id.* at ¶ 5. It also restrained all financial institutions from disbursing any funds or securities in regard to any account "in the name, on behalf or for the benefit of Defendants." *Id.* at ¶ 6.

The district court also signed an order appointing the Receiver, which grants the Receiver broad powers to "[p]erform all acts necessary to conserve, hold, manage, and preserve the value of the Receivership Estate, in order to prevent any irreparable loss, damage, and injury to the Estate." Case no. 3:09-cv-298-N, Doc. 10 at ¶ 5(g). The order specifically authorizes the Receiver to take possession of all assets "of, or in the possession or under the control of, the Receivership Estate," and also "all sums of money now or hereafter due or owing to the Receivership Estate." *Id.* at ¶ 5(b). Anticipating that additional parties could later be joined as "relief defendants," the district court further ordered all financial institutions to prohibit the withdrawal, transfer or other disposal of any funds "held by or on behalf of any . . . relief defendant in any account maintained in the name of or for the benefit of any . . . relief defendant." *Id.* at ¶ 12(a). All of these provisions likewise appear in the Amended Receivership Order. Case no. 3:09-cv-298-N, Doc. 157 at ¶¶ 5(b), (g), 15(a).

On March 2, 2009, the district court signed an Agreed Preliminary Injunction against the Stanford defendants. Case no. 3:09-cv-298-N, Doc. 80.

This order extended the TRO's prohibition against any disbursement of funds or securities in regard to any account "in the name, on behalf or for the benefit of the Entity Defendants." *Id.* at 4, ¶ V. The injunction did not modify the Receiver's powers or other restrictions on Stanford accounts set forth in the Receivership Order.

As a result of the Receivership Order and the Agreed Preliminary Injunction, all Stanford investor accounts were frozen at Pershing LLC ("Pershing"), JP Morgan Clearing Corp. ("JP Morgan") and SEI Private Trust Company ("SEI"), each of which contracted with one or more Stanford companies to provide account services for Stanford customers. Case no. 3:09-cv-298-N, Doc. 176-2, at 33-81; Doc. 321 at 2-3. On March 27th, the district court adopted procedures for the Receiver's review of the investor accounts and release of any accounts that did not appear to include proceeds of the fraudulent CDs. Case no. 3:09-cv-298-N, Doc. 239. By late June, more than 97% of investor accounts had been released from the freeze orders. Case no. 3:09-cv-298-N, Doc. 528, 529.

On June 29, the district court ordered the Receiver to complete the account review process within five weeks. Case no. 3:09-cv-298-N, Doc. 533 at 1. The court specified that all remaining account freezes would expire at noon on August 3, unless the Receiver asserted claims against the account owners and obtained injunctive relief in connection with those claims. *Id.* at 2.

III. The claims at issue on appeal

Between June 22 and July 28, 2009, the Receiver filed the claims that led to this appeal. R. 55; 69; 201. The Receiver has named as relief defendants several hundred investors who redeemed their CDs for cash before the Receivership. R. 55; 69; 201. It is beyond dispute that the cash used to make these redemptions was stolen from other Stanford investors. R. 298, 303-04, 307-08, 314-15; *see also* App. B at 14 (describing the Bank as "a massive Ponzi scheme whereby CD redemptions ultimately could only be accomplished with new infusions of investor funds"). The Receiver seeks disgorgement of this cash so that the money, along with other assets of the Receivership Estate, can be distributed pro rata to all victims of Stanford's fraud. To facilitate this equitable claim, the Receiver asked the district court for a temporary injunction that would continue the freeze on relief defendants' accounts at Pershing, J.P. Morgan and SEI until the claim was finally determined. R. 265.

On July 31, the district court held a hearing on the requested injunction. The court concluded as a matter of law that the Receiver could not prevail on any claim for "return of principal" on the redeemed CDs. R. 477-78; Tr. 47-48. Accordingly, the court froze the relief defendants' accounts going forward only to the extent of interest payments made to the relief defendants on top of their invested principal. R. 477. But on August 11, this Court extended the account

freeze on both purported principal and interest while the Court considers this appeal.

The freeze that has been in place since the Receivership was instituted has insured that hundreds of millions of stolen investor dollars will actually be available for distribution to Stanford claimants upon final adjudication of the Estate's right to them. The continuation of this freeze is necessary for the same reason. If these funds are released, they will be dispersed worldwide and only recovered, if at all, at great cost – perhaps prohibitive cost – to the Estate.

SUMMARY OF THE ARGUMENT

The claims in this case are based in equity. But there is nothing equitable about a rule that favors a few hundred Ponzi scheme investors who cashed out before court intervention over 20,000 others who did not. The relief defendants may be "innocent" because they did not realize Stanford was a sham; but they are no more innocent than any other investor. The relief defendants may have contractual claims against Stanford for return of the money they paid to purchase CDs; but these claims have no justifiable priority over the identical claims of every other investor. No one – not a relief defendant, not the SEC, and not the Examiner – has come forward with a single case holding that compensation to equally innocent victims with equally valid claims should be based on who was

quick enough, or lucky enough, to receive a pay-off with stolen money before the Ponzi scheme was revealed.

In contrast, the Receiver's claims for disgorgement of stolen money paid to the relief defendants are well-rooted in equitable principles and established case law. For example, even when investor funds can be traced to a particular investor, or were held in a segregated investor account, this Court has held that the broad powers of a district court presiding over an equity receivership allow the court to distribute the funds to all victims pro rata instead of returning them to their original owner. Courts across the country have specifically recognized the district court's power to order relief defendants to disgorge ill-gotten proceeds of an unlawful scheme so they can be shared equally with all victims. The district court erred in concluding that it lacked the power to accomplish this exact same result on the Receiver's claims for disgorgement here.

The propriety of disgorgement flows from the undisputed fact that Stanford was hopelessly insolvent when the relief defendants sought redemption of their CDs. Because Stanford was a Ponzi scheme, it did not hold onto the relief defendants' cash and was able to "return" their CD investments only by looting the more recent purchases of other innocent investors. Equity cannot tolerate this result. Equity demands equal compensation for those from whom the relief defendants' proceeds were stolen. This Court should therefore reverse the district