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

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	Case No.: 3-09-CV-0298-N
	§	
STANFORD INTERNATIONAL BANK, LTD., ET AL.,	§	
	§	
Defendants.	§	

RECEIVER'S RESPONSE TO EXAMINER'S REPORT AND RECOMMENDATION NO. 1

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In the Examiner's Report and Recommendation No. 1, the Examiner addresses three subjects: (1) the Receiver's claw-back claims, (2) the account freeze, and (3) and the account release process. The Receiver disagrees with many of the Examiner's points regarding claw-back claims and the account freeze. Decades of case decisions hold that a receiver can use legal and equitable claims, such as fraudulent transfer claims and disgorgement orders against relief defendants, in order to recover estate assets from third parties. Recovering Estate assets is one of the core legal duties of the Receiver under the Court's order, and such a duty cannot be abandoned unless there is a proper legal justification for doing so. Additionally, the Examiner's recommendation that the asset freeze be lifted is not based on proper legal principles and would cause grave harm to the Receivership by reducing substantially the likelihood of recovery of millions of dollars in Estate assets that could then be distributed to victims. Finally, the Receiver has conferred with the Examiner and agreed with his recommendations concerning the account release process. Most of these recommendations have already been incorporated into the Court's orders, and the remainder are acceptable to the Receiver and do not require further action by the Court.

I. Argument & Authorities

A. The Receiver may pursue claw-back claims against account holders, and the Examiner's criticisms of these claims are unfounded.

The Receiver agrees with the Examiner's recommendation that the Court schedule a status conference to address claw-back claims. In the interim, the following summarizes the Receiver's views on the issue. Although declining to pursue claw-back claims would undoubtedly benefit a small number of customers, this benefit would come at the expense of thousands of others.

One of the Receiver's key duties is to maximize distributions to defrauded investors and other claimants.[1] *See* Amended Order Appointing Receiver at ¶ 5(g), (j) (Doc. 157) (ordering the Receiver to "[p]reserve the Receivership Estate and minimize expenses in furtherance of maximum and timely disbursement thereof to claimants"); *Scholes v. Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995) (receiver's "only object is to maximize the value of the [estate assets] for the benefit of their investors and any creditors"); *SEC v. TLC Invs. & Trade Co.*, 147 F. Supp. 2d 1031, 1042 (C.D. Cal. 2001); *SEC v. Kings Real Estate Inv. Trust*, 222 F.R.D. 660, 669 (D. Kan. 2004). But before the Receiver can attempt to make victims whole, he must locate and take exclusive control and possession of assets of the Estate or assets traceable to the Estate. Doc. 157 ¶ 5(b).

The SEC has alleged that the Stanford companies were operated as a Ponzi scheme. First Amended Complaint, Doc. 48 ¶ 1. Payments made in the course of a fraudulent scheme are not the property of those to whom said payments were made; they are assets of the Estate, or traceable to assets of the Estate. *See SEC v. George*, 426 F.3d 786, 798 (6th Cir. 2005) (money procured by fraud and given to another does not belong to the recipient); *CFTC v. Kimberlynn Creek Ranch*, 276 F.3d 187, 191-92 (4th Cir. 2002) (recipient of proceeds of fraud had no ownership interest in the funds); *SEC v. Cavanagh*, 155 F.3d 129, 136-37 (2nd Cir. 1998) (recipient of "gift" that constituted proceeds of fraud had no legitimate claim of ownership); *SEC v. Elfindepan*, 2002 WL 31165146, at *4 (M.D.N.C. Aug, 30, 2002) (money deposited in third party's checking account as proceeds of "Note Transaction" with defendant was recoverable as asset of receivership estate).

[1] This is, of course, very similar to the trustee's role in bankruptcy. *See, e.g., In re Drexel Burnham Lambert Group, Inc.,* 123 B.R. 702, 708 (S.D.N.Y. 1991) ("A trustee in bankruptcy, under the Act and the Code, is under a duty to maximize the realization of estate liquidation. To that end a trustee must marshal the estate's assets and, if necessary to achieve that end, institute all necessary litigation.").

The Receivership Order specifically directs the Receiver to pursue litigation to "impose a constructive trust, obtain possession, and/or recover judgment with respect to persons or entities who received assets or records traceable to the Receivership Estate." Doc. 157 at ¶ 5(c). This Court has jurisdiction over any such lawsuit:

> [It is] undisputed . . . that the initial suit which results in the appointment of the receiver is the primary action and . . . *any suit which the receiver thereafter brings in the appointment court in order to execute his duties is ancillary to the main suit.* As such, the district court has ancillary subject matter jurisdiction of every such suit irrespective of diversity, amount in controversy or any other factor which would normally determine jurisdiction.
>
> "So long as an action commenced by a court appointed receiver seeks 'to accomplish the ends sought and directed by the suit in which the appointment was made, such action or suit is regarded as ancillary so far as the jurisdiction of the . . . court of the United States is concerned.'" Therefore, this court has ancillary jurisdiction over any claim brought by Reneker in order to execute his receivership duties.

Reneker v. Offill, Civil Action No. 3:08-CV-1394-D, 2009 WL 804134, at *4 (N.D. Tex. 2009) (internal citations omitted) (emphasis in original).

Claw-back claims, even against innocent investors, are one of the most important ways the Receiver fulfills his duty to maximize Estate assets for ultimate distribution.[2] Without them, the benefits and burdens of fraud would be distributed by two forces, neither of which promotes equity. The first is preferential treatment given by the defrauders themselves. There is

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[2] *See Warfield v. Byron,* 436 F.3d 551, 559-60 (5th Cir. 2006) (two investors ordered to give back proceeds of Ponzi scheme under fraudulent transfer statute); *Quilling v. 3D Marketing, LLC,* 2007 WL 1058217, at *3 (N.D. Tex. 2007) (investor who invested $100,000 in Ponzi scheme ordered to give up 100% of proceeds received, for a total of $150,000); *Mays v. Lombard,* 1998 WL 386159, at *3 (N.D. Tex. 1998) (investor had to pay back money received in excess of original investment as fraudulent transfer.); *see also Donell v. Kowell,* 533 F.3d 762, 779-80 (9th Cir. 2008) (receiver won summary judgment on fraudulent transfer theory against investor to recover false profits); *Scholes v. Lehmann,* 56 F.3d 750, 757, 759 (7th Cir. 1995) (receiver recovered from investor amounts received in excess of his principal investment as fraudulent transfers; receiver recovered from charity 100% of amounts received as fraudulent transfers.); *Wing v. Harrison,* 2004 WL 966298, at *5 (D. Utah 2004) (investors had to pay back 100% of proceeds – including their initial investment – as fraudulent transfer).

a very real risk that such preferential treatment occurred here as indicated by the following language taken from an email from the President and Director of Stanford Group (Antigua) Limited to Allen Stanford dated February 6, 2009:

> We need to come up with a strategy to give preference to certain wires to people of influence in certain countries, if not we will see a run on the bank starting next week. We all know what that means. There are real bullets out there with my name on [sic], David's name and many others and they are very real.

App. Exhibit A at 1. Based on the limited investigation to date, the Receiver has identified a number of very large cash withdrawals (totalling over $750 million) from SIBL CD accounts made during the twelve months before the SEC filed this lawsuit that did not go to Pershing accounts. Further investigation of these transactions is warranted, particularly given that the cost of such investigation is far exceeded by the amount of potential recovery and given the fact that many accounts holding such funds may be located at banks doing business in the United States.

Benefits and burdens would also be distributed by chance, which is especially prominent in Ponzi schemes. "The mere coincidence that the defendants chose the relief defendants (instead of others) to receive funds contributed by other investors in order to delay the discovery of this scheme does not entitle the relief defendants to preferential treatment." *George*, 426 F.3d at 799 ("Trying a different tack, Jackson, Harris and George contend that the amount of money they invested in the scheme should be subtracted from the amount they have been ordered to disgorge. Not true. Hundreds of other investors were victimized by this scheme, yet they will recover only 42 percent of the money they invested, not the 100 percent to which the relief defendants claim to be entitled. . . . Under these circumstances, Jackson, Harris and George may not receive a disproportionate share of the recovered investor funds, only the same pro rata share that other investors may receive.").

The reasoning that supports claw-backs is also employed by the courts when they reject the attempts of innocent investors' who invested funds in an entity to trace and identify those funds in an effort to recover the funds for themselves and avoid an equitable pro rata distribution of estate assets to all investors. Whether at any given moment a particular investor's assets are identifiable is "a result of the merely fortuitous fact that the defrauders spent the money of the other victims first." *United States v. Durham,* 86 F.3d 70, 72 (5th Cir. 1996). "To grant [a lucky subset of investors] the right to the specific funds requested would exact an inequitable result on the other hundreds of investors which are similarly situated." *In re Sprint Mortgage Bankers Corp.*, 164 B.R. 224, 229 (E.D.N.Y. 1994).

"The use of a *pro rata* distribution has been deemed especially appropriate for fraud victims of a Ponzi scheme." *SEC v. Credit Bancorp*, *Ltd.*, 290 F.3d 80, 82 (2nd Cir. 2002) (shares of stock transferred to defendant would be included in receivership estate for purposes of a pro rata distribution to defrauded victims); *SEC v. Drucker*, 318 F. Supp. 2d 1205, 1207 (N.D. Ga. 2004) (upholding pro rata distribution and denying last-in-time investor's claim that his funds were traceable). Permitting some investors, who fortuitously withdrew fraudulent proceeds in the form of interest, redemptions, or loans, to retain those funds is contrary to the fundamental concept of fairness that underlies the use of pro rata distributions. *See SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 331 (5th Cir. 2001) (noting that "the facts did not support a remedy that would elevate the [relief defendants'] claim above the other victims" even though the relief defendants *could* trace the funds they received to a segregated account containing only their investment); *SEC v. Infinity Group Co.*, 226 Fed. Appx. 217, 219 (3rd Cir. 2007) (upholding a pro rata distribution plan and refusing to let an investor keep 100% of his principal even though his money was directly traceable because "there is no equitable basis to distinguish

between early investors and those, like Roberts, who invested shortly before TIGC's account was frozen, and that all investors should thus be treated the same"); *Quilling v. Trade Partners Inc.*, 2008 WL 4283359, at *4 (W.D. Mich. Sept. 16, 2008) (denying investor's request for 100% reimbursement due to his alleged vested interest in a policy, and holding that "[i]n Receivership cases where the fraud has features that are similar or common to all victims, and at least some commingling of funds occurred, pro-rata distribution of pooled assets has been the standard").[3]

By eliminating the sources of inequity, claw-back claims play a vital role in the Receiver's efforts to mitigate the damage caused by the Defendants' fraud. As the Supreme Court noted long ago in the original Ponzi scheme case, "equality is equity." *Cunningham v. Brown*, 265 U.S. 1, 13 (1924); *see In re Sprint Mortgage Bankers Corp.*, 164 B.R. at 229. Equity therefore demands that any proceeds traceable to the fraud be recovered and distributed for the benefit of as many customers as possible, and claw-back claims are the means of satisfying this demand.

1. Fraudulent transfer actions.

A receiver of an alleged Ponzi scheme may sue under a fraudulent transfer theory to recover funds paid from the entity in receivership. *Warfield v. Carnie*, Civil Action No. 3:04-cv-633-R, 2007 WL 1112591, at *9 (N.D. Tex. 2007) (citing *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995); *In re Rodriguez*, 209 B.R. 424, 433 (Bankr. S.D. Tex. 1997); *In re Randy*, 189 B.R. 425, 438-39 (Bankr. N.D. Ill. 1995)). Most states — including Texas — have enacted a version of the Uniform Fraudulent Transfers Act ("UFTA"). *See, e.g.*, TEX. BUS. & COMM. CODE ANN. § 24.001, *et seq.* (2009). Under UFTA, a creditor can avoid fraudulent transfers

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3 *See also S.E.C. v. Behrens*, 2008 WL 2485599, at *3 (D. Neb. June 17, 2008); *SEC v. Capital Consultants, LLC.*, 397 F.3d 733, 746-47 (9th Cir. 2005); *SEC v. Merrill Scott & Assoc., Ltd.*, 2007 WL 26981, at *5 (D. Utah Jan. 3, 2007) (rejecting investors' claims to traceable funds in upholding pro rata distribution).

made by the debtor. *Id.* § 24.008(a)(1). A transfer is fraudulent if the debtor made it (1) with actual intent to hinder, delay, or defraud his creditors by placing the debtor's property beyond the creditor's reach, or (2) the debtor did not receive equivalent value and had insufficient assets to meet his obligations. *Id.* § 24.005(a).

In a Ponzi scheme, the receiver is entitled to the presumption that transfers made by the architects of the scheme are fraudulent. *See Quilling v. Schonsky*, 2007 WL 2710703, at *2 (5th Cir. 2007); *Warfield v. Byron*, 436 F.3d 551, 559 (5th Cir. 2006). In such a case, as in other cases of actual fraud, the *transferees*' intent is irrelevant to a determination of liability under the UFTA. That a defendant is an innocent investor in a Ponzi scheme and not a knowing participant is irrelevant. *See Quilling v. 3D Marketing, LLC*, No. 3-06-CV-0293-L, 2007 WL 1058217, at *3 (N.D. Tex. 2007), *adopted at*, 2007 WL 631281 (district court adopted Magistrate's Report and Recommendation, ordering investor who put $100,000 into Ponzi scheme to disgorge $150,000 in payments received, plus pre- and post-judgment interest, costs and attorney's fees). UFTA also makes injunctive relief available to preserve the status quo. TEX. BUS. & COMM. CODE ANN. § 24.008(a)(3)(A) ("[A] creditor . . . may obtain . . . an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property.").

Decades of case law clearly indicate that, when attempting to untangle the results of a Ponzi scheme, a receiver has standing to sue as a creditor[4] and may recoup funds through a

[4] *Wing v. Wharton*, No. 2:08-CV-00887-DB, 2009 WL 1392679, at *4 (D. Utah, May 15, 2009); *Wing v. Kendrick*, No. 2:08-CV-01002-DB, 2009 WL 1362383, at *2 (D. Utah, May 14, 2009); *Wing v. Hammons*, No. 2:08-CV-00620, 2009 WL 1362389, at *3 (D. Utah, May 14, 2009); *Warfield v. Alaniz*, 453 F. Supp. 2d 1118, 1127 (D. Ariz. 2006); *In re Burton Wiand Receivership Cases*, 2008 WL 818504, at *4 (M.D. Fla. 2008) (fraudulent transfers); *Hodgson v. Kottke Assocs.*, LLC, 2007 WL 2234525, at *7 (E.D. Pa. 2007); *In re Wiand*, 2007 WL 963165, at *2 (M.D. Fla. 2007); *Warfield v. Arpe*, 2007 WL 549467, at *12-13 (N.D. Tex. 2007); *Terry v. June*, 432 F. Supp. 2d 635, 644-45 (W.D. Va. 2006); *Quilling v. Cristell*, 2006 WL 316981, at *6 (W.D.N.C. 2006); *Quilling v. Grand Street Trust*, 2005 WL

fraudulent transfer action.[5] He can pursue such claims against both investors and financial advisors. *See e.g., Warfield*, 436 F.3d at 559-60 (affirming judgment against both classes of defendants).

2. *Relief defendants and disgorgement.*

The second type of claw-back claim involves seeking assets from relief defendants. A relief defendant is joined to facilitate the recovery of funds necessary to afford full relief. *See SEC v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998). No wrongdoing by the relief defendant is alleged. *See Colello*, 139 F.3d at 676; *Kimberlynn Creek Ranch*, 276 F.3d at 191-92*; Elfindepan*, 2002 WL 31165146, at *4. Courts can order disgorgement or other equitable relief against a relief defendant if "that person: (1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds." *See Cavanagh*, 155 F.3d at 136. In practice, once it is proven that distributions were made from Ponzi scheme proceeds, the courts shift the burden to the relief defendant to adduce evidence of a "legitimate claim," such as a right to compensation for services that were not in furtherance of the scheme:

1983879, at *5 (W.D.N.C. 2005); *Marion v. Benistar, Ltd.*, 2005 WL 563698, at *1 (E.D. Pa. 2005); *Warwil v. Farah*, 2003 WL 23095657, at *4-5 (S.D. Ind. 2003); *Wing ex rel. 4NExchange, L.L.C. v. Yager*, 2003 WL 23354487, at *3-4 (D. Utah 2003); *Obermaier v. Arnett*, 2002 WL 31654535, at *3-4 (M.D. Fla 2002); *Scholes v. African Enterprise, Inc.*, 838 F. Supp. 349, 356 (N.D. Ill. 1993).

[5] *Donell v. Kowell*, 533 F.3d 762, 780 (9th Cir. 2008); *Scholes v. Lehmann*, 56 F.3d 750, 759-60 (7th Cir. 1995); *Warfield*, 436 F.3d at 559-60; *Quilling v. Schonsky*, 2007 WL 2710703, at *3-4 (5th Cir. 2007); *In re Slatkin*, 525 F.3d 805, 814 (9th Cir. 2008); *SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295, 301 (5th Cir. 2007); *Sender v. Buchanan*, 84 F.3d 1286, 1290 (10th Cir. 1996); *Terry v. Dowdell*, 2006 WL 2360933, at *4 (W.D. Va. Aug. 11, 2006); *Terry v. June*, 432 F. Supp. 2d at 643; *Goldberg v. Chong*, 2007 WL 2028792, at *10 (S.D. Fla. 2007) (also recovered under unjust enrichment); *Warfield v. Carnie*, 2007 WL 1112591, at *11 (N.D. Tex. 2007); *Quilling v. Stark*, 2007 WL 415351, at *4 (N.D. Tex. 2007); *Quilling ex rel. Sardaukar Holdings, IBC v. Schonsky*, 2006 WL 3772302, at *4-5 (N.D. Tex. 2006); *Quilling v. Humphries*, 2006 WL 2934276, at *5 (N.D. Tex. 2006); *Stenger v. World Harvest Church, Inc.*, 2006 WL 870310, at *16-17 (N.D. Ga. 2006); *Stenger v. Rogers*, 2006 WL 449151, at *8 (N.D. Ga. 2006); *Wing v. Harrison*, 2004 WL 966298, at *4-5 (D. Utah 2004); *Quilling v. Gilliland*, 2002 WL 373560, at *2-3 (N.D. Tex. 2002); *SEC v. Cook*, 2001 WL 256172, at *3-4 (N.D.Tex. 2001); *Mays v. Lombard*, 1998 WL 386159, at *2-3 (N.D. Tex 1998); *Scholes v. African Enterprise, Inc.*, 854 F. Supp. 1315, 1328 (N.D. Ill. 1994).

> Alternatively, the Relief Defendants contend that the district court could not proceed against them as nominal defendants because they have asserted an ownership interest in the funds through Samuel Kingsfield's testimony during the preliminary injunction hearing that the funds were received as compensation for his services. We agree that receipt of funds as payment for services rendered to an employer constitutes one type of ownership interest that would preclude proceeding against the holder of the funds as a nominal defendant. However, a claimed ownership interest must not only be recognized in law; it must also be valid in fact. Otherwise, individuals and institutions holding funds on behalf of wrongdoers would be able to avoid disgorgement (and keep the funds for themselves) simply by stating a claim of ownership, however specious.

Kimberlynn Ranch, 276 F.3d at 192; *see Cavanagh*, 155 F.3d at 136; *SEC v. Cherif*, 933 F.2d 403, 414 n.11 (7th Cir. 1991); *SEC v. Milan Capital Group, Inc.*, 2000 WL 236374, at *3 (S.D.N.Y. 2000). Courts can also impose a preliminary injunction freezing assets held by the relief defendant to preserve the availability of final equitable relief. *See Cavanagh*, 155 F.3d at 136-37; *SEC v. Dowdell*, 2002 WL 31357059, at *1-2 (W.D. Va. 2002); *Elfindepan*, 2002 WL 31165146, at *2; *SEC v. Amerifirst Funding*, 2008 WL 282275, at *1 (N.D. Tex. 2008).

Case law amply supports the power of a receiver to seek disgorgement of tainted funds from relief defendants who receive proceeds from a Ponzi scheme.[6] When the relief defendant is an investor, proceeds of the fraud can include both the "profit" and the principal amount of the third party's original investment in the fraudulent scheme. *See George*, 426 F.3d at 799.

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[6] *SEC v. George*, 426 F.3d 786, 798-99 (6th Cir. 2005); *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1116 (9th Cir. 2006); *SEC v. Infinity Group Co.*, 212 F.3d 180, 193 (3rd Cir. 2000); *Quilling* 2007 WL 1058217, at *4; *SEC v. Alanar, Inc.*, 2008 WL 1994854, at *5-6 (S.D. Ind. 2008); *SEC v. Cross Fin. Servs.*, 908 F. Supp. 718, 730 (C.D. Cal. 1995); *Commodity Futures Trading Comm'n v. Bolze*, 2009 WL 1313249, at *2 (E.D. Tenn. 2009); *SEC v. AmeriFirst Funding, Inc.*, 2008 WL 1959843, at *2 (N.D. Tex. 2008); *Commodity Futures Trading Comm'n v. Foreign Fund*, 549 F. Supp. 2d 1005, 1008 (M.D. Tenn. 2008); *Commodity Futures Trading Comm'n v. Foreign Fund*, 2007 WL 1850007, at *5 (M.D. Tenn. 2007); Dowdell, 2002 WL 31357059, at *4-5; *SEC v. Chem. Trust*, 2000 WL 33231600, at *11-12 (S.D. Fla. 2000); *SEC v. Better Life Club of Am., Inc.*, 995 F. Supp. 167, 184 (D.D.C. 1998); *SEC v. Infinity Group Co.*, 993 F. Supp. 324, 331 (E.D. Pa. 1998).

3. *Claw-back claims are proper against customers accused of no wrongdoing, and the Receiver does not intend to pursue claw-back claims only against customers with accounts at Pershing or JP Morgan.*

The Examiner recommends that claw-back claims not be pursued for two reasons. First, he expressed reservations about the pursuit of claw-back claims against Stanford customers who have done nothing wrong. Exam. Rep. at 4. But as the case law amply demonstrates, claw-back claims against customers accused of no wrongdoing are entirely proper and serve a larger equitable purpose. Although the Examiner says that none of the cases relied on by the Receiver in discussions between the Examiner and the Receiver involved a situation truly analogous to that before the Court, Exam. Rep. at 5, the facts of those cases prove otherwise. By definition, relief defendants are accused of no wrongdoing; every case in which a relief defendant was ordered to disgorge supports the Receiver's intention to pursue claw-back claims in this case. For example, in *SEC v. George*, the SEC alleged that the defendants violated the securities laws by running a Ponzi scheme, and the district court ordered investors not accused of any wrongdoing to disgorge not only proceeds they received from the scheme, but also interest on those proceeds, despite the fact that they received much less than their principal investment.[7] According to the court, this relief was appropriate in order to maximize the return of money to

[7] The SEC secured summary judgment against several relief defendants in the *George* case. In its Reply on one such motion, the SEC stated: "[I]t is legally irrelevant whether a relief defendant knows of the defendant's fraud. *See SEC v. Colello*, 139 F.3d 674, 675 (9th Cir. 1998) (Colello dismissed as a defendant and named as a relief defendant after Commission failed to obtain preliminary injunction against him). Finally, Mojica argues that he is innocent and therefore prejudgment interest should not be awarded against him. Mojica's position is wrong as a matter of law. In Commission law enforcement actions, prejudgment interest is available and appropriate against relief defendants, who necessarily are not charged with wrongdoing. . . . Mojica admits that he received $416,512 from Thorn and Estrada. He does not deny that the money came from investors. Mojica made use of the money for his own benefit. Given these facts, it would be unfair for Mojica to be allowed to benefit from his use of investor money, while the investors suffer the loss of their money. Mojica should be ordered to disgorge $416,512 plus prejudgment interest." Brief, App. Exhibit B at 17 (citations omitted).

investors as a whole. 426 F.2d at 788, 791. *George* is therefore clearly analogous to the present case.

Second, the Examiner is concerned that the Receiver will selectively pursue claw-back claims "against a relatively small number of Stanford customers . . . simply because those customers have assets that are frozen at Pershing." Exam. Rep. at 4. According to the Examiner, equity demands that the Receiver not "pick and choose from among the otherwise innocent" by pursuing "only the most handy victims." *Id.* at 5. Such concerns are unfounded. The Receiver is not targeting a fraction of investors or limiting his claims to Pershing accounts, nor has he ever stated any such limitation. The Receiver has not completed the process of investigating, let alone pursuing, the large cash withdrawals from Stanford International Bank that were *not* funneled through Pershing or JP Morgan, other than to simply identify that such events occurred. Once that investigation has reached a more advanced stage, the Receiver will be in a better position to evaluate the viability of claw-back claims against customers other than those with accounts at Pershing or JP Morgan.

4. The inability to recover all CD-related proceeds is not a reason to abandon efforts to recover what can be recovered.

The Examiner suggests that it would be inequitable if the Receiver is successful in pursuing claw-back claims against some investors but not against others. The Receiver agrees it is likely that there will be some persons who redeemed CDs before February 16, 2009 whose redemption proceeds will never be recovered, for one reason or another. The inability to recover their proceeds may be seen as inequitable as between them and those whose proceeds are recovered. But the abandonment of efforts to recover any such proceeds for the reason that not all such proceeds can be recovered is surely not equitable from the standpoint of the more than 20,000 persons who continue to hold CDs today. Claw-back claims should be evaluated and

pursued based on a cost/benefit analysis, in which the costs to the Estate of pursuing a claim are compared to the benefits to be achieved (considering both the likelihood of recovery and the amount to be recovered if successful).

It is not an uncommon problem in litigation that some defendants are judgment-proof; despite a finding of liability, money may not be recoverable because it has been spent or dissipated, or the recipient may have moved the money or himself beyond the jurisdiction of the U.S. courts. The Receiver has not yet determined the location of, or how difficult it would be to recover, all the monies subject to possible claw-back claims. It would be an abdication of his court-ordered duties for the Receiver to terminate recovery efforts during the earliest stages of his investigation.

B. The Court should reject the Examiner's recommendation that all Stanford customer accounts be released from the asset freeze.

The accounts that remained frozen after the Court's March 12, 2009 Order and have not been thereafter released pursuant to the account review process are (1) accounts held by an individual defendant, or held by any person who was affiliated with a defendant or entity controlled by a defendant as a shareholder, director, senior manager, or registered representative or financial advisor whose earnings were based on certificates of deposit or who owed loans to Stanford Group Company; (2) accounts owned for the benefit of the individual defendants or Stanford companies; (3) accounts having at least $250,000 in assets and which the Receiver determines may contain proceeds from the allegedly fraudulent products or activities; (4) accounts that secure unpaid balances owed by customers or non-purpose loans made to customers; and (5) accounts that are related to (1) through (4) by social security number or tax identification number. Second Order Authorizing Release of Certain Customer Accounts, Doc. 156.

The Examiner has recommended that "all remaining Customer Accounts held at Pershing or JPMorgan for the purpose of supporting the Receiver's 'claw-back' claims be released to their owners."[8] Exam. Rep. at 6. He makes three arguments against the freeze: (1) that it is contrary to law, (2) that it is too expensive, and (3) that it imposes undue hardship on account holders. None of these arguments are well-founded in the law.

As a preliminary matter, it should be noted that the Court has already heard and rejected similar arguments. On April 20, the Court denied over forty motions to intervene brought by hundreds of account holders. Order at 1 (Doc. 321). In addition to requesting intervention, these motions attacked the asset freeze, raising some of the same arguments as the Examiner does here. *See, e.g.*, Amended Motion to Intervene and Motion to Dissolve or Modify Temporary Restraining Order and Preliminary Injunction and Brief in Support Thereof at ¶¶ 1, 16-17 (Doc. 148)(claiming asset freeze created unnecessary hardship, was contrary to due process and was a *de facto* attachment). The Receiver defended the freeze against these arguments in his consolidated response. Receiver's Consolidated Opposition to Motions to Intervene at 10–13, 26-31 (Doc. 176). After full briefing on the merits, the Court denied the motions and continued the freeze in force. (Doc. 321 at 32–33) ("The preliminary injunctions were warranted when issued, and they remain warranted today.").

1. *The freeze order is supported by ample legal authority.*

"It is a recognized principle of law that the district court has broad powers and wide discretion to determine the appropriate relief in an equity receivership." *SEC v. Great White Marine & Recreation, Inc.*, 428 F.3d 553, 556 (5th Cir. 2005) (citation omitted). Likewise, "[t]he district court has broad equitable powers to fashion appropriate relief for

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[8] The Examiner recommends the release of accounts in categories 1 and 3 above, except those owned by individual Defendants. Exam. Rep. at 6 n.9.

violations of the federal securities laws." *SEC v. First Pac. Bancorp.*, 142 F.3d 1186, 1193 (9th Cir. 1998); *SEC v. Am. Bd. of Trade, Inc.*, 830 F.2d 431, 438 (2nd Cir. 1987) (court may "grant 'ancillary relief . . . where necessary and proper to effectuate the purposes of' the securities laws").

The courts' equitable powers extend over third parties. *See, e.g.*, *Liberte Capital Group, LLC v. Capwill*, 462 F.3d 543, 551-52 (6th Cir. 2001) (approving blanket stay of litigation against receiver and defendants, including litigation brought by third parties); *Colello*, 139 F.3d at 676 (approving the use of "nominal defendants" to recover the proceeds of fraud from third parties).

In such cases, ancillary relief may, and very frequently does, include an asset freeze. *See Elfindepan*, 2002 WL 31165146, at *5-6 (freeze, even on assets under exclusive control of third parties, necessary to preserve status quo); *Am. Bd. of Trade*, 830 F.2d at 438; *SEC v. ETS Payphones, Inc.*, 408 F.3d 727, 735-36 (11th Cir. 2005). An asset freeze is designed to preserve the status quo and prevent dissipation of the frozen assets before final relief is granted. *See ETS Payphones*, 408 F.3d at 734; *CFTC v. Am. Metals Exch. Corp.*, 991 F.2d 71, 79 (3rd Cir. 1993); *see also Am. Bd. of Trade*, 830 F.2d at 438-39 (affirming asset freeze where SEC offered substantial evidence that (1) the SEC would ultimately prevail on its claim to the assets, and (2) there was a "clear danger" that the assets would be depleted in the absence of a freeze); *SEC v. Hickey*, 322 F.3d 1123, 1131-32 (9th Cir. 2003) (district court had equitable authority to freeze assets of third party in order to protect and give life to disgorgement and contempt orders against defendant; this power did not depend on alter ego theory – "That Hickey may have been clever enough to organize a completely separate, successful entity, and construct a unique employment compensation agreement covering all of his personal expenses using

corporate assets, does not put him beyond the reach of a court's powers of disgorgement."). An asset freeze is particularly justified where a receiver needs more time to investigate the underlying fraud. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1105-06 (2nd Cir. 1972) (affirming an asset freeze "designed to preserve the status quo while the court could obtain an accurate picture of the whereabouts of the proceeds" of the fraud).

The Examiner's position would create an anomalous gap in the Court's equitable powers. District courts would be powerless to stop dissipation of assets early in a receivership where the available evidence indicates that certain assets are the proceeds of fraud, but where more evidence is needed to establish the elements of claw-back claims against particular persons. It simply makes no sense to permit third parties unfettered control over the proceeds of fraud – over which they may have some control but which they do not own – and hope these funds can be recovered later:

> The Relief Defendants' theory would force the SEC to name all possible relief defendants and permit each of them to litigate their respective ownership interests before an injunction could issue to protect defrauded investors. Given the court's broad equitable powers to afford relief to defrauded investors, the better approach is to permit the SEC to identify a source of fraudulent funds and freeze them pending resolution. Parties in possession of such funds who do not have a legitimate ownership interest and who are given notice of the freeze are not prejudiced by such a freeze as they are not deprived of their own property.

Elfindepan, 2002 WL 31165146, at *4 (sanctioning relief defendant for spending funds under his exclusive control after receiving notice of freeze on all funds received from defendant). Equity demands a mechanism for preserving the status quo upon a showing of *likely* success on the merits, as with any other preliminary injunction. The Court's "broad powers and wide discretion to determine the appropriate relief in an equity receivership" put that mechanism on a sound legal footing. *Great White Marine*, 428 F.3d at 556 (citation omitted).

In this case, an asset freeze is warranted to prevent dissipation of assets before claw-back claims can be pursued. District courts have "broad equitable powers . . . to recover ill gotten gains for the benefit of the victims of wrongdoing, whether held by the original wrongdoer or by one who has received the proceeds after the wrong." *Colello*, 139 F.3d at 676. This power supports temporarily freezing assets that are *likely* to be ill-gotten gains, until the propriety of bringing claw-back claims can be determined. *See Cavanagh*, 155 F.3d at 136 (affirming asset freeze where district court found that "the SEC is likely to be able to show" that a relief defendant did not have a legitimate claim to the proceeds). In terms of the equitable power of the Court, such a freeze is no different from any other preliminary injunction designed to maintain the status quo until a final determination on the merits can be made.

The Examiner argues that the freeze order "effectively accomplished a pre-judgment attachment of assets," and that "[s]uch an attachment is improper and should not be permitted to continue." Exam. Rep. at 7-8. He reasons that Federal Rule of Civil Procedure 64 controls the availability of a pre-judgment attachment, that Rule 64 instructs courts to follow state law, and that Texas law does not support attachment in this case. *Id.* But this argument misses the mark. The availability of a freeze order in a federal securities law case is not governed by Rule 64, and state law is therefore irrelevant. *See SEC v. Unifund SAL*, 910 F.2d 1028, 1041 (2nd Cir. 1990) ("The [freeze] order functions like an attachment. That does not mean, however, that its issuance must be tested against state law standards, as would be the case if the relief were sought pursuant to rule 64 of the Federal Rules of Civil Procedure."); *Fed. Sav. & Loan Ins. Corp. v. Dixon*, 835 F.2d 554, 560 (5th Cir. 1987) (distinguishing attachment under Rule 64 from an interlocutory freeze order). Instead, federal equitable principles control. *See Unifund*, 910 F.2d at 1041 ("[I]t is a matter of federal law whether the showing the Commission

has made is sufficient to support an interlocutory freeze order."); *see also SEC v. HealthSouth Corp.*, 261 F. Supp. 2d 1298, 1319 (N.D. Ala. 2003); *Cavanagh*, 155 F.3d at 136 ("The standard of review for an injunction freezing assets of a relief defendant is whether the SEC has shown that it is likely to succeed on the merits[.]").

The Examiner also argues that "[t]here is ample authority for the proposition that, in an SEC-instigated receivership, it is improper to freeze assets that belong to a third party who has done nothing wrong." Exam. Rep. at 8. But the Examiner cites only two cases in support of this argument, both of which are distinguishable.

The Examiner first cites *SEC v. Cherif* for the proposition that "a district court may not take the assets of a non-culpable third party because 15 U.S.C. § 78u (d) and (e) permit the district court to exercise its equitable powers only over the defendants or other persons before the court." Exam. Rep. at 8-9 (citing *Cherif*, 933 F.2d at 413). *Cherif* actually acknowledged the need for an asset freeze until the propriety of naming a relief defendant could be determined. Rather than reversing the asset freeze in that case, the court allowed the freeze (already twenty three months old) to remain in effect for fourteen more days so that the third party's status as either a defendant (culpable in the fraud) or relief defendant (innocent of wrongdoing) could be determined at an evidentiary hearing. *See id.* at 415.

Furthermore, the facts of *Cherif* differ dramatically from this case. First, this case involves a receivership, whereas *Cherif* did not. As noted above, a district court "has broad powers and wide discretion to determine the appropriate relief in an equity receivership." *Great White Marine*, 428 F.3d at 556 (citation omitted). Second, the equities of an asset freeze are much stronger in this case than in *Cherif*. The number of victims with an equitable claim to compensation from the Stanford Receivership Estate numbers in the thousands (there are more

than 20,000 holders of SIBL CDs), whereas the wrongful acts in *Cherif* were victimless, thus diminishing the importance of preventing dissipation. *See* 933 F.2d at 406 (describing the wrongful acts as trading securities based on confidential information). Third, the need to preserve the status quo to keep funds available for claw-back claims militates strongly in favor of an asset freeze, whereas no comparable need existed in *Cherif*. The fraud in this case is a vast and complex fraudulent scheme, spanning five continents, over 100 companies, and many years, yet the Receiver has had only three months to investigate. The fraud in *Cherif* involved illegal trading activity by no more than two people, *Id.* at 406-07, and by the time the Seventh Circuit issued its opinion, the freeze had already been in place for almost two years. *See id.* at 403, 407. The equities in favor of an asset freeze here simply dwarf those in *Cherif*.

The Examiner also cites *SEC v. Black* for the proposition that "it is improper for a district court to freeze assets owned by third parties who are not alleged to be 'wrongdoers,' as contemplated by 15 U.S.C. § 78u (d) and (e), when those assets are not the property of any defendants." Exam. Rep. at 8 (citing *SEC v. Black*, 163 F.3d 188, 196 (3rd Cir. 1998)). The *Black* court affirmed a district court order lifting a freeze on third parties' assets. *Id*. at 198. Nevertheless, as with *Cherif*, the equities supporting an asset freeze are much stronger in this case than in *Black*. The Receiver has had only had three months to investigate a vast, complex fraudulent scheme, whereas the *Black* receiver had had almost eight months to investigate a much smaller and simpler scheme by the time the district court lifted the freeze. *Id.* at 192–93. Thus, the need to preserve the status quo while the proceeds of fraud are located is much greater in this case. Moreover, the risk of dissipation is much greater here than in *Black*. The *Black* court noted that "no party has argued that lifting the freeze would result in the dissipation or removal of assets from the jurisdiction of the court." *Id.* at 198 n.7. In fact, the court observed

that the holders of the frozen accounts were "school districts presumably with ample funding, who are available to receive service of process." *Id.* By contrast, if the freeze is lifted in this case, dissipation will be immediate and widespread. For example, many account holders are foreign nationals who are likely to remove funds from the United States as soon as the freeze is lifted. The importance of this distinction cannot be emphasized enough, because the very point of an asset freeze is to prevent dissipation until final relief can be awarded.

Moreover, to the extent *Cherif* and *Black* might have supported the Examiner's position when they were decided in the 1990s, intervening changes in the law undermine their holdings. Both cases rely in large part on the text of 15 U.S.C. § 78u. *See Cherif*, 933 F.2d at 413-14 ("Nothing in the statute or case law 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."); *Black*, 163 F.3d at 196 (quoting *Cherif*, 933 F.2d at 413-14)). At the time, 15 U.S.C. § 78u only provided for injunctions against a person who "is engaged or is about to engage" in violations of the securities laws. 15 U.S.C. § 78u(d)(1) (West 1997). But the Sarbanes-Oxley Act of 2002 amended section 78u to clarify the broad powers of district courts in securities law cases: "In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, *any equitable relief that may be appropriate or necessary for the benefit of investors*." 15 U.S.C. § 78u(d)(5). This amendment overturned any implied Congressional intent to limit the district courts' injunctive powers to "wrongdoers."[9] An order freezing the assets of a third party falls comfortably within

[9] This conclusion is bolstered by the fact that, even prior to the 2002 amendment, many courts held that a district court's injunctive powers extend over third parties to the action. *See, e.g.*, *Liberte Capital Group, LLC v. Capwill*, 462 F.3d 543, 551-52 (6th Cir. 2001) (approving blanket stay of litigation against receiver and defendants, including litigation brought by third parties); *Colello*, 139 F.3d at 676 (approving the use of "nominal defendants" to recover the proceeds of fraud from third parties). These courts clearly rejected the notion that Congress implicitly intended to limit injunctive powers to "wrongdoers."

the amended language, especially when the freeze is a temporary one designed to preserve the status quo until the Receiver can determine which account holders qualify as relief defendants. Under the circumstances of this case, freezing the accounts so that tainted funds can be segregated is undoubtedly "appropriate or necessary for the benefit of investors." *Id.*

In sum, the Court's order temporarily freezing the assets of the Stanford account holders is justified as an exercise of the Court's broad equitable powers in a securities law receivership. Given the early stage of the Receiver's investigation and the high risk of dissipation if the freeze is lifted, the freeze should be left in place until the Receiver can finish identifying which accounts warrant pursuit of claw-back claims and bring such claims.[10]

2. *The freeze order is equitable and narrowly tailored to preserve the Receiver's ability to recover Estate assets.*

The Examiner further challenges the freeze order by pointing to its costs. He cites the Receiver's recent fee application for $19.9 million in fees and expenses, a portion of which was attributable to dealing with the account freeze and account releases. Exam. Rep. at 9-10.

[10] To the extent the Examiner challenges the freeze on financial advisors' accounts, his arguments are equally unavailing. Both the March 5 and March 12 release orders maintained the freeze on the accounts of at least some financial advisors. *See* Order Authorizing Release of Certain Customer Accounts at 1 (Doc. 117) (freezing accounts of "certain [Stanford] employees (identified by the Receiver in his sole discretion)"); Second Order Authorizing Release of Certain Customer Accounts at 1–2 (Doc. 156) (freezing accounts of "financial advisor who earned commissions or fees based on certificates of deposit or owed loans to Stanford Group Company"). These accounts were frozen because the information available to the Receiver at the time enabled him to "identify accounts that may contain proceeds from the allegedly fraudulent products or activities" — in other words, accounts subject to claw-back claims. Receiver's Second Motion for Order Authorizing Release of Certain Customer Accounts at 7 (Doc. 153). In fact, this information was substantial enough that the Receiver subsequently named 66 financial advisors as relief defendants. *See* Receiver's Complaint Naming Stanford Financial Group Advisors as Relief Defendants (Doc. 302).

The freeze is valid with respect to the financial advisors named as relief defendants. *See SEC v. Cavanagh*, 155 F.3d 129, 136 (2nd Cir. 1998). Even *Cherif* and *Black* acknowledge the propriety of asset freezes against relief defendants. *See SEC v. Cherif*, 933 F.2d 403, 414 (7th Cir. 1991); *SEC v. Black*, 163 F.3d 188, 197 (3rd Cir. 1998). The freeze is also valid with respect to any financial advisors not yet named as relief defendants for the same reasons given above with respect to other account holders.

He also notes that the freeze order is imposing hardships upon people who have done nothing wrong. *Id.* at 10.

The Receiver does not dispute that the freeze order entails costs, whether measured by dollars spent administering the order or by the hardship imposed on some account holders. But because a freeze order is an equitable remedy, "the disadvantages and possible deleterious effect of a freeze must be weighed against the considerations indicating the need for such relief." *Manor Nursing Ctrs., Inc.*, 458 F.2d at 1106.

The current freeze order is the product of exactly that kind of weighing process, and is narrowly tailored to produce the maximum benefit to victims at minimum cost. Roughly 32,000 Pershing and JP Morgan accounts were frozen by the Court's initial freeze order. *See* Report of the Receiver Dated April 23, 2009 at 45 (Doc. 336). The Receiver subsequently engaged in a balancing of the hardship the freeze was causing to owners of the accounts compared to the benefits of the freeze to the Estate. *Id.* at 44. Where the equities weighed against continuing the freeze, the Receiver obtained Court approval to release the frozen accounts. *Id.* Of the 32,440 Stanford Group Company customer accounts at Pershing and J.P. Morgan that were initially frozen, a total of 28,600 were released under the March 5 and March 12 orders.

The equities weigh in favor of continuing the freeze in its present, narrowly tailored form. Many of the accounts that remain frozen have been determined to contain proceeds of the fraud and hence are subject to claw-back claims; many of the others are likely to contain proceeds of the fraud and are being evaluated as expeditiously as possible. Given the risk of dissipation if the accounts are released, the freeze order is a necessary tool for maximizing the amount of funds available for distribution to victims.

An initial analysis of a subset of accounts which remained frozen after the March 5 and March 12 orders showed the following: (1) 100 account holders with over $174 million of recoverable assets in their Pershing accounts, and (2) another $56 million of recoverable assets in accounts held by Stanford financial advisors. This is a substantial sum of Estate assets which will be placed at risk if the account freeze is lifted prematurely. The Receiver does not yet have an estimate of the total amount of recoverable assets in all of the remaining frozen Pershing accounts, but given what has been identified in the above subset of frozen accounts, such amount is likely to be substantial.

3. The Receiver is working expeditiously to complete the account review process..

A total of 30,142 accounts have been released as of June 5, 2009, either pursuant to the Court's March 5 or March 12 orders or pursuant to the ongoing account review program. At that date, as a result of the account review program, an additional 116 accounts have been identified as having assets that are less in value than the potential claw-back claims against the account or its owner and an additional 627 accounts are the subject of a proposed partial release (in which the Receiver proposes, subject to customer agreement, to release all assets in excess of the amount that would be needed to satisfy potential claw-back claims against the account or its owner). Another 179 accounts may be released at any time if the customer pays off existing debit balances, and 155 accounts are owned by the Stanford entities, an individual defendant or Stanford directors, officers or senior management. The Receiver is evaluating which of the remaining 1,159 frozen Stanford Group Company accounts (consisting of 420 accounts owned by former Stanford financial advisors and 739 accounts owned by persons not affiliated with the

Defendants) should be released, using data furnished by the customer in account review applications[11] and/or data otherwise available to the Receiver.

With respect to Stanford Trust Company, 1,438 accounts were originally frozen. Of these, 122 accounts remain frozen today. The others have been released either pursuant to the Court's April 23, 2009 order or pursuant to the authorization in the May 27, 2009 order to release accounts that had only de minimis amounts of CD related proceeds. The 122 accounts that remain frozen contain approximately $35 million of CD related proceeds.

When fraud is practiced on such a massive scale for such a long period of time, the necessity of preventing dissipation inevitably causes temporary hardship for some. But the current freeze order appropriately balances these costs against the benefits to the victims as a whole. For these reasons, the freeze order should remain in effect.

C. The Receiver has accepted and is implementing the Examiner's recommendations concerning the release process.

The Examiner's recommendations in Parts V.A.1–4 of the Examiner's Report were incorporated into the Court's order of May 21. *See generally* Agreed Order Granting Receiver's Unopposed Motion to Supplement the Court's Order Granting Receiver's Unopposed Motion to Approve Procedures to Apply for Review and Potential Release of Accounts (Doc. 394). The Receiver is currently implementing the Court's order.

The Receiver has accepted the Examiner's recommendation in Part V.B.1, which deals with the release of customer accounts that are not needed to meet the customer's holdback amount. The Receiver has been implementing this recommendation since May 21. No further action from the Court is needed.

[11] As of June 5, 299 account review applications had been filed but not yet processed.

Finally, the Receiver accepts the Examiner's recommendation in Part V.B.2 that the Receiver review and release customer accounts even if customers have not submitted the Receiver's application materials. The Receiver will implement this recommendation after all applications have been reviewed and resolved. No new or different procedures will be needed once those accounts are identified.

II. Conclusion

WHEREFORE, the Receiver respectfully submits this Response to the Examiner's Report and Recommendation No. 1 and requests that the Court take the following actions:

a. that the Court accept the Examiner's recommendation that a status conference be scheduled to address the Receiver's claw-back claims; and

b. that the Court reject the Examiner's recommendation that the freeze on certain Stanford customer accounts be lifted.

Dated: June 5, 2009

Respectfully submitted,

BAKER BOTTS L.L.P.

By: / s / Kevin M. Sadler

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CERTIFICATE OF SERVICE

On June 5, 2009, I electronically submitted the foregoing document with the clerk of the court of the U.S. District Court, Northern District of Texas, using the electronic case filing system of the court. I hereby certify that I have served the Court-appointed Receiver, all counsel and/or pro se parties of record electronically or by another manner authorized by Federal Rule of Civil Procedure 5(b)(2).

/s/ Kevin M. Sadler
Kevin M. Sadler