IN THE UNITED STATE DISTRICT COURT FOR
THE MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

BURTON W. WIAND, as Receiver for HOWARD WAXENBERG TRADING L.L.C., HKW TRADING LLC, HKW TRADING FUND I LLC., DOWNING & ASSOCIATES TECHNICAL ANALYSIS, and the ESTATE OF HOWARD WAXENBERG

Plaintiff,

v.

COTTAGE DEVELOPMENT LLC; COURT STREET LLC; and BRANDON ABRAHAM, Individually and as Trustee for the BRANDON ABRAHAM 1989 TRUST,

Defendants
_____/

Case No. 8:06-cv-609-T-27MSS
Case No. 8:06-cv-615-T-27MSS
Case No. 8:06-cv-618-T-27MSS

DEFENDANTS' COTTAGE DEVELOPMENT LLC, COURT STREET LLC AND BRANDON ABRAHAM'S RESPONSE TO THE RECEIVER'S OBJECTIONS TO JANUARY 28, 2008 REPORT AND RECOMMENDATION

Defendants Cottage Development LLC, Court Street LLC and Brandon Abraham (collectively, "Defendants") hereby respond to the Receiver's Amended Objections (the "Objections") to the Magistrate Judge's January 29, 2008 Report and Recommendation (the "R&R), filed by Burton W. Wiand, as Receiver (the "Receiver") for Howard Waxenberg Trading L.L.C., HKW Trading LLC, HKW Trading, Fund I LLC ("HKW"), Downing & Associates Technical Analysis, and the Estate of Howard Waxenberg (collectively the "Receivership Entities"), and state as follows:[1]

[1]Undersigned counsel represents all Defendants (as defined herein) with respect to the Receiver's claims that are the subject of the R&R. Because the R&R orders all defendants in those actions to file common responses to the Objections (R&R at 57), this identical Response is being filed in each case (i.e., with respect to each Defendant). For the sake of brevity, only

FACTUAL BACKGROUND

Defendants are all former investors in the Receivership Entities. Each Defendant requested and received a refund of its investment between one and three months prior to the demise of the Receivership Entities and subsequent appointment of the Receiver. With his various lawsuits, the Receiver is seeking to require Defendants and numerous other investors to pay their respective investments back into the Receivership Entities based on theories of fraudulent transfer and unjust enrichment. Each of the Defendants filed a motion to dismiss (collectively, the "Motion to Dismiss" [D.E. 39]) seeking dismissal of all claims for their refunded principal and the R&R recommends dismissal of those claims. This Response responds to the Receiver's Objections to the R&R's recommendation in that regard.[2]

ANALYSIS

I. This Court Should Adopt the R&R and Dismiss All Claims Under FUFTA Because the Receiver is Not Seeking to Recover "Property of the Debtor."

This Court has already found that only a creditor may bring claims against Defendants under Florida Statutes Chapter 726, Florida's Uniform Fraudulent Transfer Act ("FUFTA"). Omnibus Order, Dated March 28, 2007 [DE 34] (the "Omnibus Order") at 7-8 (holding that "[t]o utilize the protections of [FUFTA] . . . a plaintiff must show that he or she has a 'claim' which qualifies the party as a 'creditor'" (citing *Freeman v. First Union Nat'l Bank,* 865 So.2d 1272, 1277 (Fla. 2004))

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documents filed with respect to the action against Court Street LLC (Case No. 8:06-cv-615) will be cited herein (using the abbreviation "DE #" to represent the respective docket entry number in that case). The arguments and references apply equally to the documents filed in connection with the other Defendants' cases.

[2] The Receiver is also seeking to recover the relatively small amounts received by Defendants over and above what the Defendants invested, the so-called "false profits." Only the principal investments are at issue in the Defendants' Motion to Dismiss; therefore, this Response does not respond to those aspects of the Objections that address the R&R's findings with respect to alleged false profits.

and dismissing FUFTA claim because the Receiver failed to allege that plaintiff is a "creditor" under FUFTA). With his Amended Complaint, the Receiver addressed this defect in the original Complaint not by alleging that he is a creditor of the Receivership Entity that allegedly made the transfers at issue, but that he is a creditor of Howard Waxenberg ("Waxenberg"), the individual who allegedly controlled the Receivership Entities. R&R at 13. The problem with the Receiver' approach is that FUFTA only allows a plaintiff to recover an asset if it was the "property of the debtor" at the time it was transferred. Fla. Stat. § 726.102(2). Objections at 2 (stating that "FUFTA permits avoidance of a transfer of 'an asset' or an 'interest in an asset' [and a]n 'asset' is defined as 'property of a debtor'" (citing Fla. Stat. §§ 726.102(2) and (12)). And, as the detailed analysis set forth in the R&R establishes, there is no way that the funds that were transferred to Defendants could have been "property of the debtor" (i.e., Waxenberg) at the time those funds were transferred to Defendants. R&R at 13-25.

With his Objections, the Receiver urges this Court to reject the R&R's finding in this regard based on two arguments. The Receiver's first argument is that "the money the FUFTA claims seek to recover is property of the debtor because it [was] available 'to pay the debt due' by Waxenberg." Objections at 2-3. The Receiver's second argument is that "other courts have allowed receivers to avoid fraudulent transfers under similar circumstances as in this case." Objections at 3-4. Both of the Receiver's arguments should be rejected by this Court.

A. The Receiver Uses Tortured Logic to Conclude That He is Seeking to Recover the "Property of the Debtor."

Again, the Receiver admits in his Objections that FUFTA only allows avoidance of transfers of the "property of a debtor." Objections at 2 (citing Fla. Stat. § 726.102(2)). As the R&R explains, the funds that were transferred to the Defendants from the Receivership Entities were not "property

of the debtor" (i.e., property of Waxenberg) based on any meaningful definition of the phrase. Indeed, the R&R points out that, according to the Receiver's own allegations, the funds at issue were property of ***the Receivership Entities*** at the time they were transferred to Defendants. R&R at 15-16 (observing that "[t]he Receiver has alleged unequivocally in most instances that the assets transferred and sought to be recaptured were those of the Receivership Entities"). *See, e.g.*, Amended Complaint [D.E. 36] at 10 (alleging, in connection with the transfers in question, that "Waxenberg improperly ***caused the Receivership Entities to purportedly return principal to certain investors***" (original in all caps) (emphasis added)).

The Receiver argues that, contrary to the reasoning in the R&R, whether or not the transfers in question were actually the "property of the debtor," according to the ordinary understanding of that term, should not be the focus of an analysis determining whether the Receiver is entitled to assert claims against the Defendants under FUFTA. Objections at 3. Instead, the Receiver argues, the focus should be on whether the transferred funds were "property which could have been applicable to the payment of the debt due." *Id*. (quoting *Nationsbank v. Coastal Utilities, Inc.*, 814 So.2d 1227, 1229 (Fla. 4th DCA 2002)). According to the Receiver, because the funds, again funds ***that even according to his own allegations indisputably belonged to the Receivership Entities***, could have been applicable to a debt that Waxenberg allegedly owes to the Receivership Entities, those funds were the property of Waxenberg for the purposes of FUFTA. Objections at 2-3.

But this is just tortured logic. Property can not simultaneously belong to and be owed to the same party–in this case the Receivership Entities. To use another example, if the Receiver's logic were valid then the property of a debtor would also be the property of that debtors guarantor (and vice versa) merely because the property of either "could [be] applicable to the payment of the debt due."

The absurdity of the Receiver's "focus" for determining whether the transferred funds were the property of the Waxenberg is practically self evident.

The Receiver's doctrinal justification for his novel approach toward defining "property of the debtor" is a misleading interpretation of the holding in *Nationsbank* and another case the Receiver cites, *Huntsman Packaging Corp. V. Kerry Packaging Corp.*, 992 F. Supp. 1439, 1446 (M.D. Fla. 1998). Objections at 2. Unlike here, in both *Nationsbank* and *Huntsman* the respective debtors had valid property interests in the funds that had been transferred. Neither of those cases held that the term "property of the debtor" should be defined any more broadly than the ordinary sense that is reflected in the R&R. Specifically, in *Nationsbank* the issue was whether the debtor had a property interest in all of the funds that had been transferred out of a joint account. 814 So.2d at 1229-30. In that case, the court concluded that only those funds to which the debtor had an actual ownership interest could be considered "property of the debtor." *Id*. This holding is entirely consistent with the reasoning set forth in the R&R. So too is the holding in *Huntsman*. In that case the transferred assets at issue were ***all*** of the assets the debtor owned. 992 S.2d at 1443. The court in that case reasoned that because those assets were not exchanged for reasonably equivalent value, they had been fraudulently conveyed. *Id*. at 1445. Again, consistent with the analysis in the R&R, all of the assets in that case that were subject to a FUFTA claim were owned by the debtor at the time the transfer was made.

The R&R characterized the Receiver's novel argument that the transfers of funds in question were "property of the debtor" as follows:

> In essence, the Receiver contends because the debtor, Waxenberg, exercised control over the assets in the nanosecond of time during which the transfers to investors occurred, he had a sufficient interest in the assets such that they became the 'property

> of the debtor' for purposes of FUFTA (and to preserve his standing argument, simultaneously remained property of the Receivership Entities).

R&R at 16. And, as the R&R also notes, the Receiver failed to cite a single case in his Global Opposition to the Motions to Dismiss the Amended Complaints [D.E. 42] that employed his novel argument. *Id.* at 16-22. As pointed out above, the Receiver also failed to cite such a case in his Objections.

In short, the funds that were transferred to the Defendants were not "the property of Waxenberg" according to any reasonable definition of the term. Therefore, whether the Receiver is a creditor of Waxenberg is of no moment because only the property of Waxenberg is the proper subject of a legitimate FUFTA claim in which Waxenberg is the debtor.

B. The Additional Cases Cited by the Receiver in his Objections in Support of his FUFTA Claim Are Inapposite Because This Court Has Already Held that the Receiver May Only Assert a FUFTA Claim if the Receiver is a Creditor.

As additional authority for his FUFTA claim, the Receiver cites numerous cases in which a receiver asserts claims under the respective state's version of the Uniform Fraudulent Transfer Act. Objections at 3-4. But all of the Receiver's cases are inapposite because none of them address the basis of the R&R's recommendation that the FUFTA claim be dismissed–this Court's pleading requirement that the Receiver come under FUFTA's definition of "creditor." Omnibus Order at 7-8. Indeed, the Receiver implicitly admits in his Objections that none of the cases cited by the Receiver hold that a similarly situated receiver was properly defined as a creditor under FUFTA. Objections at 3 (admitting that "the Receiver found no published decision squarely addressing whether a Ponzi scheme perpetrator who causes an entity he or she owns and controls to transfer its assets to investors (and others) is transferring 'property of a debtor'").

In sum, the Receiver failed to show that the Amended Complaint complies with the pleading requirement set forth in the Omnibus Order that the Receiver must be a "creditor" in order to bring claims under FUFTA. Therefore, this Court should adopt the R&R's finding that the Receiver's FUFTA claims against the Defendants be dismissed.

II. This Court Should Adopt the R&R's Recommendation That the Unjust Enrichment Claims Against Defendants For Refunds of Their Principal Investments Be Dismissed.

Defendants argued in the Motion to Dismiss [D.E. 39] that Defendants were not unjustly enriched when they received refunds of their investments into the Receivership Entities. *Id*. at 7-10. Therefore, Defendants argued, the Receiver's unjust enrichment claims for the return of principal should be dismissed. *Id.* Defendants observed that the Receiver failed to cite a single case in which a Receiver prevailed on such a claim that amounted to a claim to "equitably distribute misery among a Ponzi scheme's victims." *Id*. at 7. The Motion to Dismiss also cites numerous cases supporting the principle that a legitimate unjust enrichment claim could seek, at most, the return of amounts received in excess of the amount invested. *Id.* at 7-10. The R&R primarily cited a case heavily relied on by the Receiver, *Scholes v. Lehmann*, 56 F.2d 750 (7th Cir. 1995), in making precisely the appropriate distinction:

> The Scholes Court . . refused to permit the receiver to obtain a full disgorgement of investors' repayment, holding that the victims of the fraud are only required to return "the difference between what was] put in at the beginning and what [was retained] at the end." That difference is the only amount that could be said to be unjustly retained by Defendants.

R&R at 29 (citing *Scholes*, 56 F.2d at 757-58) (emphasis in original). The R&R went on to reason that:

> While it may be unjust or unfair ***against the so-called 'unsuccessful investors'*** in that the successful investors would received a greater portion of their initial fraud losses,

> it is undisputed on this record that the Receiver lacks standing to pursue claims for the other unsuccessful investor/creditors of the Receivership Entities.

R&R at 29 (emphasis added) (citing *Freeman v. Dean Witter Reynolds, Inc.*, 865 S.2d 543, 550 (Fla. 2d DCA 2003). In other words, the R&R found that a receiver simply lacks standing to create new victims of a Ponzi scheme fraud in order to help mitigate the effects of the Ponzi scheme on its established victims.

The Receiver's Objections admit that courts have been unwilling to allow receivers to assert unjust enrichment claims to recover returns of principal: "the Receiver acknowledges the distinction generally made by courts between recovery by receivers of false gains (*i.e.*, amounts received by an investor in excess of the principal investment) and purported returns of principal." Objections at 5. The Receiver's only substantive[3] arguments are (i) certain policy arguments for allowing a receiver to behave as a "surrogate of the SEC" (Objections at 5-7) and (ii) to try to distinguish the facts in *Scholes* from those here (Objections at 7). The Receiver's policy argument utterly contradicts the settled limits on his authority. Specifically, the Receiver asserts that when bringing claims that would result in the same remedy the Receiver seeks here, "the SEC does not sue on 'behalf of specific creditors;' instead, it sues to enforce federal securities laws to protect the integrity of securities transactions and investors in general." *Id*. at 6-7. This is precisely the reason the Receiver should not be permitted to act as a "surrogate for the SEC." The Receiver, unlike the SEC, is not chartered with the responsibility to protect the integrity of the securities markets. His responsibility, like

[3] The Receiver also implicitly makes the procedural argument that this Court has supposedly ruled that the Receiver may bring its claims for unjust enrichment because the Omnibus Order did not dismiss the unjust enrichment claims in the Receiver's original Complaints. Objections at 4-5. Defendants have already presented an argument addressing this argument by the Receiver in their Motion to Dismiss [D.E. 39] at p. 6. For the sake of brevity, the Defendants' argument is not repeated herein.

practically all equity receivers, is to act as a surrogate of the defunct enterprise for the benefit of its creditors. *See generally*, Order Appointing Receiver, Case No. 8:05-CV-1076-T-24MSS, United States District Court, Middle District of Florida, [D.E. 75] (nowhere stating that the Receiver has authority to assert claims on behalf of the SEC or to take actions to protect the integrity of the securities markets); *see also* Transcripts of Proceedings before Hon. Mary S. Scriven, United States Magistrate Judge, dated November 17, 2006 [D.E. 26] at 74 (counsel for the Receiver admitting that the Receiver's "power and authority is exclusively as defined by the Order appointing Mr. Wiand as the Receiver. That is the whole extent of [his] authority").[4]

And the Receiver's attempt to distinguish the facts here from those in *Scholes* is ineffectual. The Receiver merely recites various of the more sensational facts in the case (such as that Waxenberg died by way of suicide) and argues that such facts were not considered in *Scholes*. Objections at 7. But the Receiver in no way explains why these distinctions make a difference. That is, he never explains why the particular facts here give rise to unjust enrichment claims on the return of principal

[4] The Receiver also relied heavily on *SEC v. George*, 426 F.3d 786 (6th Cir. 2005), a case which allows a governmental agency to disgorge repayments of principal to some investors for distribution to other defrauded investors. The R&R primarily distinguished this case on the most obvious ground that it involves an action by a governmental agency–not an action, such as this one, brought by a receiver. R&R at 29. Defendants urge that the holding in *George* should be rejected on the additional ground that it was decided wrongly. The only authority cited by the court in *George* for disgorging the repayment of principal from innocent investors were cases involving the disgorgement of funds from parties that either (a) were anything but innocent, *Commodity Futures Trading Com'n v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187 (4th Cir. 2002) (disgorged fruits of fraud from nominal defendant), and *S.E.C. v. Colello*, 139 F.3d 674 (9th Cir. 1998) (recovered $2.6 from nominal defendant who tenuously claimed it was a "fee for services"), or (b) had no property interest whatsoever in the funds transferred, *SEC v. Cherif*, 933 F.2d 403, 414 (7th Cir.1991) and *SEC v. Cavanagh*, 155 F.3d 129, 136 (2d Cir.1998). *George*, therefore, is really an anomaly even in the context of governmental enforcement actions. Extending its holding to apply to unjust enrichment claims brought by receivers against innocent investors would not only be anomalous–it would vest receivers with powers that even governmental agencies do not have.

while the facts in *Scholes* (which, at bottom, involved a company that was run no less as a Ponzi scheme than the Receivership Entities) did not.

In sum, the Objections (1) failed to cite a single case in which an equitable receiver was given the power to recover an investor's refunded principal investment; (2) failed to persuasively distinguish the holding in *Scholes* that such an action does ***not*** exist and (3) failed to persuasively support the Receiver's policy argument for vesting equitable receivers with the enforcement powers of the SEC. For all of these reasons, the R&R should be adopted by the Court and all claims for unjust enrichment for the return of the Defendants' own principal investment should be dismissed.

CONCLUSION

For the reasons stated herein, Defendants respectfully request that the Court adopt the R&R and dismiss with prejudice (i) the Receiver's FUFTA claims against Defendants and (ii) all claims for unjust enrichment against Defendants based on the return of their own investment principal.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was served on the parties to this action by way of filing through the CM/ECF electronic filing system on the 27th day of February, 2008.

/s/ Guy F. Giberson
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