UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. Case No. 8:09-cv-0087-T-26TBM

ARTHUR NADEL,
SCOOP CAPITAL, LLC,
SCOOP MANAGEMENT, INC.

Defendants,

SCOOP REAL ESTATE, L.P.
VALHALLA INVESTMENT PARTNERS, L.P.,
VALHALLA MANAGEMENT, INC.
VICTORY IRA FUND, LTD,
VICTORY FUND, LTD,
VIKING IRA FUND, LLC,
VIKING FUND, LLC, AND
VIKING MANAGEMENT,

Relief Defendants.
_____/

THE RECEIVER'S REPLY TO QUEST ENERGY MANAGEMENT GROUP, INC.'S OPPOSITION TO THE RECEIVER'S MOTION TO EXPAND THE SCOPE OF RECEIVERSHIP

Quest Energy Management Group, Inc.'s ("**Quest**") Opposition (the "**Opposition**") (Doc. 1003) to the Receiver's Motion to Expand the Receivership to include Quest (the "**Motion**") (Doc. 993) confirms the key fact here: Quest received $5.1 million in proceeds from Arthur Nadel's Ponzi scheme (the "**scheme**") beginning only two months after Quest was incorporated and used that money to acquire significant assets. Indeed, Quest admits those proceeds represented the vast majority of its initial funding. Burton W. Wiand, as Receiver (the "**Receiver**"), negotiated a resolution with Quest that would have avoided its inclusion in this

Receivership, but Quest failed to honor its commitments and obligations under it. Now, Quest's attorneys have informed the Receiver they will move to withdraw from their representation of Quest. While they did not provide a reason, it appears Quest is in financial straits. Because Quest's procedural objections are meritless; it was funded largely with scheme proceeds; and its financial position is now so precarious, it should be included in this Receivership to preserve and enable the Receiver to extract its remaining value – otherwise, in all likelihood the Receivership (and Quest's other investors) will be left with nothing.

I. THE COURT HAS JURISDICTION OVER QUEST

Quest argues the Court lacks jurisdiction over it because the Receiver did not serve it with process. Opp. at 4-5. This is wrong for two independent reasons: (1) the Receiver complied with the requirements of 28 U.S.C. § 754 ("**Section 754**"), which in turn gives the Court "complete jurisdiction and control" over all Receivership property, including assets funded with scheme proceeds and held by non-parties like Quest; and (2) because this is a summary proceeding, the Receiver was only required to provide Quest with notice and an opportunity to be heard.

A. The Court Has Jurisdiction Over Quest Under Section 754

The Opposition ignores the Receiver's compliance with Section 754, which provided this Court "complete jurisdiction and control" over all Receivership property in the federal jurisdiction in which Quest is located, including over Quest itself since it was funded with scheme proceeds. Specifically, on March 7, 2013, the Court re-appointed the Receiver (Doc. 984), and on March 12, 2013, the Receiver filed a copy of that order and the complaint underlying this action in the United States District Court for the Northern District of Texas – *i.e.*, "the district court for the district in which [Quest] is located." *See* 28 U.S.C. § 754; *S.E.C. v. Nadel et al.*, Case No. 3:13-mc-00033-D (N.D. Tex.). This fully complied with the requirements

of Section 754, and thus the Court obtained jurisdiction over Quest. *See, e.g., SEC v. TLC Invs. & Trade Co.*, 147 F. Supp. 2d 1031, 1035 (C.D. Cal. 2001); *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986); *U.S. Commodity Futures Trading Comm'n v. Lake Shore Asset Mgmt. Ltd.*, 2010 WL 960362, *6 (N.D. Ill. 2010).

Quest relies on *S.E.C. v. Ross*, 504 F.3d 1130 (9th Cir. 2007), but that case is distinguishable for two independent reasons. First, unlike here it did not involve the use of summary proceedings "simply to obtain equitable relief from a non-party against whom no wrongdoing is alleged…" *Id.* at 1144. Rather, the receiver accused the non-party in that case of selling unregistered securities and sought disgorgement of the non-party's commissions. *Id.* The court held that "because the [r]eceiver's disgorgement claim turns on [the non-party's] own violation of the securities laws," the receiver could not treat the non-party as a nominal defendant or constructive trustee holding scheme proceeds. *Id.* Here, unlike the non-party in *Ross*, the Moodys "funneled the proceeds of [their and Nadel's wrongdoing] into the corporation [*i.e.*, Quest]," and the Receiver is entitled, at minimum, to the return of that money for the benefit of the Receivership estate. But because Quest admits it used the initial $4 million in transfers to acquire and develop oil leases (Downey Aff. ¶ 32), and it does not have sufficient cash to even make interest payments on the $1.1 million Note (Wiand Decl. ¶ 30), the Receiver has no choice but to move the Court to include Quest in this Receivership to preserve the value of its assets, which Quests holds merely as a constructive trustee for the Receivership's benefit.

Second, the receiver in *Ross* failed to provide "any evidence that the proceeds … [were] located in the District of Oregon, or that he ha[d] attempted to establish control over out-of-district assets pursuant to § 754." *Id.* at 1146. Thus, the court held it could not "justify the use of summary proceedings" "[a]bsent some evidence that [the receiver] has obtained jurisdiction

over these assets." *Id.* Here, the record establishes Quest is located in the Northern District of Texas; it used scheme proceeds received from the Moodys to purchase interests in oil-producing land in Texas; and the Receiver filed in accordance with Section 754 in every federal district in Texas.[1] As such, the restriction on summary proceedings discussed in *Ross* does not apply here.

B. Quest Received Adequate Notice And An Opportunity To Be Heard

Although Quest argues the Receiver should have served it with formal process, it ignores this is a summary proceeding so there is no summons or complaint to serve on Quest. Rather, Quest is only entitled to notice of the Receiver's Motion and an opportunity to be heard. *See, e.g., S.E.C. v. Wencke*, 783 F.2d 829, 835-36 (9th Cir. 1986) (affirming use of summary procedures and rejecting argument Receiver was required to file "a formal complaint" and serve "summonses"); *In re San Vicente Medical Partners Ltd.*, 962 F.2d 1402, 1408 (9th Cir. 1992) ("In sum, a district court has the power to include the property of a non-party … in an SEC receivership order as long as the non-party … receives actual notice and an opportunity for a hearing."); *Warfield v. Alaniz*, 453 F. Supp. 2d 1118, 1133 (D. Ariz. 2006) ("A receiver in a S.E.C. action may petition the court for an order to show cause against a possessor of money belonging to the receivership who is not a party to the original S.E.C. action. This sort of summary proceeding satisfies the requirements of procedural due process so long as the non-party is provided with adequate notice and opportunity to be heard." (citation omitted)); *S.E.C. v. Abbondante*, 2012 WL 2339704, *2 (D.N.J. 2012) ("Summary proceedings may be conducted without formal pleadings, on short notice, without summons and complaints, generally on affidavits, and sometimes even ex parte."). Here, the Receiver undisputedly provided notice, by mailing the Motion to Quest and its counsel: Quest's filing of the Opposition demonstrates it

[1] *S.E.C. v. Nadel et al.*, Case No. 3:13-mc-00033-D (N.D. Tex.); *S.E.C. v. Nadel et al.*, Case No. 6:13-mc-13 (E.D. Tex.); *S.E.C. v. Nadel et al.*, Case No. 7:09-mc-00032-D (S.D. Tex.); *S.E.C. v. Nadel et al.*, Case No. SA09-mc-456 (W.D. Tex.).

received notice. It also demonstrates Quest received an opportunity to be heard. Accordingly, this Court has jurisdiction over Quest and its assets.

II. QUEST WAS FOUNDED AND FUNDED WITH SCHEME PROCEEDS

Quest contends it can only be included in this Receivership if it was an *alter ego* of Viking Oil, Valhalla, or another Receivership Entity, but that contention relies on an overly narrow characterization of relevant authorities and ignores the salient issue. Specifically, the contention is overly narrow because Quest used the scheme proceeds it received through the Moodys, Viking Oil, and Valhalla primarily to lease, develop, and profit from land in Texas. *See* Downey Decl. ¶¶ 19, 20. As such, this matter is equivalent to cases in which courts routinely authorize receivers to take possession of and sell land or homes purchased or improved with Ponzi scheme proceeds. *S.E.C. v. Lauer*, 2009 WL 812719, *3 (S.D. Fla. 2009) (holding that "when tainted funds are used to pay costs associated with maintaining ownership of [a] property, the property itself and its proceeds are tainted by the fraud"); *In re Fin. Fed. Title & Trust, Inc.*, 347 F.3d 880 (11th Cir. 2003) (imposing constructive trust on property purchased with Ponzi scheme proceeds); *S.E.C. v. Kirkland*, 2006 WL 2639522, *2-3 (M.D. Fla. 2006) (expanding receivership "[b]ecause the evidence tends to show that the property was purchased with funds from receivership entities"); *Commodity Futures Trading Commn. v. Hudgins*, 620 F. Supp. 2d 790, 795 (E.D. Tex. 2009).

Further, the salient issue here is that Quest was funded with, and indeed, founded on more than $5.1 million in scheme proceeds stolen from defrauded investors. Quest admits it was created in November 2005 with $750,000 from 23 investors – *i.e.*, an average of approximately $32,600 per investor. *See* Downey Aff. ¶¶ 2, 17. Yet, only two months later, in January 2006, the Moodys transferred $3 million of scheme proceeds to Quest. *Id.* ¶ 19; *see* Mot. at 7-9. Thus, according to Quest itself, 80% of its initial funding came from Nadel's scheme. That $3 million

represented 92 times more than the average initial investor contributed and 4 times more than the total amount **all** initial investors contributed to Quest. In short, Quest was overwhelmingly funded with and founded on scheme proceeds, and for this reason alone it should be added to this Receivership.

Quest argues it later raised an additional $1.4 million from other investors and obtained $500,000 in bank financing in 2006 and 2007. *See* Downey Aff. ¶¶ 21, 22. But during that same period, it also received another $1.6 million in scheme proceeds through Viking Oil and Valhalla. *Id.* ¶¶ 20, 23. Even if true, **63%** of Quest's money through 2007 was nonetheless undisputedly scheme proceeds.

There is no "magic" number at which it becomes inappropriate to add Quest to this Receivership because, as explained in the Motion, courts have held that "*any* comingling [of scheme proceeds and purportedly legitimate money] is enough to warrant treating all the funds as tainted." *S.E.C. v. Byers*, 637 F. Supp. 2d 166, 177 (S.D.N.Y. 2009). Because "money is fungible" it is "impossible to differentiate between 'tainted' and 'untainted' dollars. . . ." *Lauer*, 2009 WL 812719 at *4-5. "Once proceeds become tainted, they cannot become untainted." *United States v. Ward*, 197 F.3d 1076, 1083 (11th Cir. 1999).

Between 2008 and 2013, Quest purports to have raised more money from other investors (*see* Downey Decl. ¶¶ 25-27), but it inexplicably failed to use that money to re-pay its obligations under the Note or to otherwise refund the $5.1 million scheme proceeds it concededly received.[2] Instead, it used a portion of the money to hire Chris Moody as a "consultant." The Receiver and Quest eventually had a proposed compromise, but Quest admits it failed to pay the amount it agreed and represented it could pay. *See id.* ¶¶ 39-42. Although the

[2] Even considering all of the additional money purportedly invested in Quest, its other purported investors each contributed on average approximately $121,000 while Receivership Entities contributed $5.1 million, or over 42 times as much money as the average "investor."

Opposition relies on the existence of additional money and investors, it ignores that Quest was founded and funded with scheme proceeds, that those funds were integral to its existence and that Quest has failed to comply with previous attempts to resolve this matter.[3]

III. A SUMMARY PROCEEDING IS NECESSARY HERE AND DOES NOT VIOLATE QUEST'S DUE PROCESS RIGHTS

Quest admits the "Note created a preferred lien in favor of Valhalla on all of the then-issued shares in Quest," and it "does not dispute that the Receiver is entitled to sue Quest based on that lien." *See* Opp. at 11 (emphasis added). Nevertheless, it argues that use of summary proceedings to include Quest in Receivership is inappropriate because it would purportedly violate its due process rights by depriving it of discovery and "a full and fair opportunity to put on evidence and assert its claims and defenses." *Id.* This argument is wrong for two reasons: (1) summary proceedings are not only permissible here, they are necessary because only this Court in this case can grant the relief requested in the Motion, and (2) Quest's purported defenses lack merit as a matter of law, and based on the undisputed facts, discovery is not required.

A. Summary Proceedings Are The Only Way The Relief Requested In The Motion Can Be Granted

Summary proceedings are not only permissible here, they are necessary because the relief requested in the Motion can only be granted in this case. Quest's suggestion that the Receiver sue it in an independent action under the Note completely ignores the critical role that scheme proceeds have played in its existence. There is no way for the Receiver to account for that

[3] Adding Quest to this Receivership will not automatically terminate the rights of other purported investors in Quest. Instead, it will allow the Receiver to preserve the value of Quest's assets and ensure the benefits of those assets flow to those who equitably are entitled to them rather than to Quest's officers as is currently happening. Indeed, given the Receiver's mandate and this Court's equitable powers, the Receiver can likely extract value from Quest in a way that its current management cannot. *S.E.C. v. TLC Invs. & Trade Co.*, 147 F. Supp. 2d 1031, 1035 (C.D. Cal. 2001) ("[A] primary purpose of equity receiverships is to promote orderly and efficient administration of the estate by the district court for the benefit of creditors").

without adding Quest to this Receivership, and that relief can only be granted through summary proceedings in this case.

B. As A Matter Of Law And Fact, Quest's Purported Defenses Lack Merit

Quest's asserted defenses lack any merit as a matter of law and based on the undisputed facts. Quest interposes three defenses: (1) the Moodys purported indefinite extension of the Note until Quest raised certain unspecified sums; (2) Quest's purported claim against Viking Oil for more than $4.8 million; and (3) Quest's alleged need for and entitlement to discover whether Viking Oil and Valhalla are *alter egos* and thus whether Quest is entitled to offset its claim against Viking Oil against the amount it owes Valhalla under the Note. *See id.* at 10. As explained below, these purported defenses are meritless, and they do not raise any genuine issues of material fact requiring discovery or additional proceedings.

1. Quest Defaulted On The Note With Respect To Both Principal And Interest

Quest's defense of an indefinite extension of its Note by the Moodys fails first because, even if the Moodys made such an agreement, the Receiver terminated it; and second, even setting aside the repayment of principal, Quest nevertheless defaulted because it has not made an interest payment since January 7, 2013.

As an initial matter, Quest has not presented any evidence the Moodys agreed to extend the Note indefinitely aside from its CEO's self-interested affidavit; but even if it did, the Receiver terminated any such agreement on October 21, 2011 – *i.e.*, more than 18 months ago. Specifically, the Note states that "Payee, <u>in its sole discretion</u>, may extend the time for payment of the debt evidenced hereby, in whole or in part, at any time voluntarily and/or at the request of the Debtor, <u>without in any way otherwise affecting the liability of the Debtor</u>." *See* Wiand Decl., Ex. F (emphasis added). Valhalla is the Payee under the Note. *Id.* Even if the Moodys agreed to

such an extension, they were divested of the authority to act for Valhalla when the Receiver was appointed in January 2009. Consequently, on October 21, 2011, the Receiver (on behalf of Valhalla, the Payee) demanded Quest and the Downey's repay the full principal amount of the Note ($1,100,000), together with then-accrued interest ($9,166.67). *See* Wiand Decl. ¶ 26, Ex. I. Undisputedly, this terminated that purported agreement "without in any way otherwise affecting the liability of the Debtor." *See id.*, Ex. F.

Second, notwithstanding Quest's refusal to repay the $1.1 million in principal due under the Note for at least 18 months, Quest has also failed to make interest payments under the Note since January 7, 2013. *See id.* ¶ 30. "[T]he failure of Debtors to make payment" is an express Event of Default under the Note. *See id.*, Ex. F. Because Quest has failed to make payments for three months and counting, it currently owes Valhalla more than $27,000 in interest (plus the outstanding principal) and is indisputably in default under the Note. As such, Quests first purported defense is meritless as a matter of both law and undisputed fact.

2. Any Claim Quest May Have Had Against Viking Oil Is Forever Barred And Enjoined; As Such, No Discovery Is Necessary

Quest next argues it has a claim against Viking Oil for more than $4.8 million, and because it may have a right of offset against the Note, it is entitled to discovery to determine whether Viking Oil and Valhalla are *alter egos*. *See* Opp. at 10. This is wrong because Quest never filed a claim with respect to Viking Oil or anything else in the claims process in this case, so any claim it may have had is now forever barred and enjoined. Because Quest has no claim against Viking Oil, that entity's relationship to Valhalla is irrelevant.

Specifically, on June 4, 2010, the Receiver mailed a Notice to Creditors and Proof of Claim form to Quest because, although it was not an investor in the scheme, it was a potential creditor of Receivership Entities. A copy of that mailing is attached as **Exhibit A**. In relevant

part, the Notice to Creditors made two important and clear disclosures: (1) all claims against Receivership Entities – which included Viking Oil and Valhalla – whether mature or not, had to be submitted by September 2, 2010, and (2) anyone who did not comply with that deadline would be forever barred and enjoined from asserting a claim. *Id.* Similarly, the Proof of Claim form warned:

> IF THIS COMPLETED FORM … IS NOT RECEIVED BY THE RECEIVER … BY **SEPTEMBER 2, 2010**, YOU WILL BE FOREVER BARRED FROM ASSERTING ANY CLAIM AGAINST THE RECEIVERSHIP ENTITIES' ASSETS…

Id. Finally, the Receiver included a cover letter that made clear that "[f]ailure to timely return a completed and signed Proof of Claim for an account will forever bar any claim related to that account." *Id*. Despite all of these warnings, Quest never filed a claim. As such, any claim Quest may have had against Viking Oil (or any other Receivership Entity) is now forever barred and enjoined. *See* Doc. 1002 (refusing to allow late-filed claim). Because Quest has no claim against Viking Oil, that entity's relationship to Valhalla (including whether they were *alter egos*) is irrelevant, and no discovery is necessary to resolve the Receiver's Motion.

CONCLUSION

Because Quest was founded and funded with scheme proceeds, the Court should add it to this Receivership so the Receiver may extract all remaining value out of Quest for the benefit of this Receivership and anyone else who is equitably entitled to it. Anything short of including Quest in Receivership – such as requiring the Receiver to file an independent action – will not adequately protect this Receivership (or any other Quest investors) and, at the end of the day, the judgment recovered by the Receiver likely would have been for less – if any – value than including Quest in Receivership at this time.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on April 26, 2013, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system.

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