Securities and Exchange Commission v. Nadel et al Doc. 1048

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. CASE NO: 8:09-cv-87-T-26TBM

ARTHUR NADEL; SCOOP CAPITAL, LLC; and 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, LLC,

Relief Defendants.
_______________________________________/

FULCRUM DISTRESSED OPPORTUNITIES FUND I, LP'S MEMORANDUM OF LAW IN SUPPORT OF ITS OBJECTION TO THE RECEIVER'S PROPOSED TREATMENT OF CLAIM NUMBER 445

Fulcrum Distressed Opportunities Fund I, LP ("Fulcrum"), by and through its undersigned counsel, files this Memorandum of Law in Support of its Objection to the Receiver's Proposed Treatment of Claim Number 445 (the "Memorandum") in accordance with this Court's Order dated July 3, 2013 (Doc. 1034), and respectfully states as follows:

SUMMARY OF ARGUMENT AND BURDEN OF PROOF

Fulcrum acquired Claim Number 445 from Genium AI Fund Series 1 Ltd. Standard Portfolio and Genium Trading Company Ltd.[1] (together, the "Genium Entities"), which invested

[1] In connection with the Genium Entities' investment in Valhalla, Canrol was acting as nominee for Union Bancaire Privée, a Swiss bank and 100% owner of Canrol.

Dockets.Justia.com

in the receivership entities through Canrol Finance Ltd. ("Canrol"). The Genium Entities lost their entire $1,195,000.00 investment in just a few months, and did not receive any profits from the receivership entities. The Genium Entities were good faith investors in Valhalla with no actual or constructive knowledge that they were investing in a fraudulent scheme. The Genium Entities, like hundreds of other similar investors, were defrauded by the scheme perpetrated by Nadel. The Genium Entities lost their entire principal and never received any transfers from the Receivership Entities in the form of return of principal or profits.

Notwithstanding this, the Receiver now seeks disallowance of Claim 445 for two reasons. First, the Receiver seeks disallowance of Claim 445 because the Genium Entities did not provide him with the discovery he sought regarding beneficial holders before the arbitrary deadline that he set. Second, the Receiver seeks disallowance of Claim 445 because the Genium Entities were not "mom and pop" investors, but rather investment professionals.

In attempting to disallow or subordinate Claim 445 on these grounds, the Receiver ignores well-settled case law that liberally allows a claimant to amend or supplement its claim in a bankruptcy or receivership case, and seeks to equitably subordinate Claim 445 without any showing that the Genium Entities engaged in the sort of inequitable conduct generally required for subordination.

As an initial matter, the Receiver's position that Claim 445 should be disallowed, or if allowed that it should be equitably subordinated, is not entitled to any deference from this Court.[2] This Court must conduct a *de novo* review of the validity of Claim 445 where the burden

[2] In *MBIA Ins. Corp. v. FDIC*, 816 F.Supp.2d 81 (D.D.C.2011), MBIA Insurance Corporation filed a complaint against the FDIC asserting claims arising from the failure of IndyMac Bank and its subsequent resolution by the FDIC. *Id.* at 83. The *MBIA* Court stated, "FDIC Receiver made its own determination that MBIA's claims should be treated as general creditor claims and not administrative expenses entitled to priority payment. While acknowledging that MBIA is entitled to *de novo* review of its claims by this Court, FDIC Receiver argues that its determination is entitled to deference. '[B]ecause the FDIC is charged with administering this highly detailed

of overcoming the *prima facie* validity of Claim 445 and burden of establishing that Claim 445 should be equitably subordinated once it is allowed remains with the Receiver. The Receiver is not a referee or special master, whose determinations of claims are entitled to any special deference or presumption of validity. The Receiver is a litigant party like a Chapter 7 bankruptcy trustee or even Fulcrum.

Further, Fulcrum submits that it is the Receiver's burden to provide evidence that Claim 445 is not valid, and that is also his burden to establish that Claim 445, if allowed, should be subordinated. In bankruptcy, a proof of claim constitutes *prima facie* evidence of the validity and amount of the claim.[3] *See* F.R.B.P. 3001(f). The party objecting to the validity of a proof of claim has the burden of supplying sufficient evidence to overcome the presumption of validity. *See In re Circle City Transport, Inc.*, 2011 WL 5239706 *1 (Bankr. M.D. Ala. Oct. 31, 2011); *In re Bleu Room Experience, Inc.*, 304 B.R. 314, n. 5 (Bankr. E.D. Mich. 2004).

Taking these standards into account, the Court should reject the Receiver's determination and allow Claim 445 in full. In seeking disallowance of Claim 445, the Receiver has not met his burden to overcome the presumption that Claim 445 is valid. This is understandable, since the Receiver advances neither argument nor evidence tending to show that the Genium Entities did not, in fact, invest the amounts indicated in Claim 445 or suffer the losses claimed in Claim 445.

---

regulatory scheme, [courts] may resort to its body of experience and informed judgment for guidance to the extent that its position is persuasive.' FDIC Receiver's letter disallowing MBIA's claims is cursory, however, and therefore entitled to limited deference." *Id.* at 100 n.21 (internal citation omitted).

[3] A proof of claim need not meet the standards for pleading particular claims applicable under the Federal Rules of Civil Procedure. *See In re O'Malley*, 252 B.R. 451, 456 (Bankr. N.D. Ill. 1999). Rather, a proof of claim need only state sufficient information to "fairly alert" the estate. *See Gens v. Resolution Trust Corp.*, 112 F.3d 569, 575 (1st Cir. 1997); *see also In re Charter Co*, 876 F.2d 861, 863 (11th Cir. 1989). In order to "fairly alert" the estate, a proof of claim need only provide "adequate notice of the existence, nature, and amount of the claim as well as the creditor's intent to hold the estate liable." *See Gens*, 112 F.3d at 575.

The Receiver's own calculations – the Net Invested Amount[4] - confirm that Claim 445 was asserted against the proper entity and in correct amount. The Receiver's only issue with Claim 445 itself is that it did not include the list of parties with an interest in the Genium Entities, an issue Fulcrum has diligently sought to cure through amendment. This failure of discovery, however, does not render Claim 445 untimely or otherwise so flawed as to justify disallowance.

The Receiver's only somewhat substantive argument also ignores the validity of the investments and losses indicated in Claim 445, and relates solely to his classification of the Genium Entities as "sophisticated investors." However, this distinction, as demonstrated in further detail herein, has no bearing on whether Claim 445 should be disallowed, thus denying the Genium Entities any recourse for the actual, valid losses they suffered from the fraud perpetrated in this case.

The Receiver's objections to Claim 445 should be overruled by this Court. The Receiver has not, and cannot, provide evidence sufficient to carry his burden on either the issue of allowance or subordination. Consequently, this Court should enter an order allowing Claim 445 *pari passu* with all other allowed Class 1 Claims, direct the Receiver to remit the first and second interim distribution that he has reserved for the eventual allowance of Claim 445 to the current owner of Claim 445 (Fulcrum), and order the Receiver to send all future distributions on Claim 445, on par with all other Class 1 Claims, to Fulcrum.

---

[4] The Net Investment Amount "was calculated by adding all amounts contributed by pertinent investors to an account and subtracting all distributions made to that accountholder, regardless of whether those distributions were characterized as interest, earnings, returns of principal of by any other terminology. In other words, the Net Investment Amount reflects dollars an investor actually deposited in the scheme minus the dollars that investor actually received from the scheme." *See* Claim Determination Motion pages 5-6. Claim 445 is asserted for $1,195,000.00, which is the exact amount the Genium Entities invested in Valhalla and the exact amount that the Receiver calculated as the Net Investment Amount.

RELEVANT BACKGROUND

1. In July 2008, the "Genium Entities, through Canrol, invested $1,195,000.00 in Hedge Fund Valhalla Investment Partners, L.P. ("Valhalla"). (Statement of Undisputed Facts, Doc. 1038 at ¶ 1).[5]

2. On January 21, 2009, less than six months after the Genium Entities invested in Valhalla, the Securities and Exchange Commission ("SEC") initiated this action. That same day, the Court entered an order appointing Burton W. Wiand as Receiver for various entities, including Defendants Scoop Capital, LLC and Scoop Management, Inc. and the Hedge Funds as Relief Defendants (the "Order Appointing Receiver"). (SOUF ¶ 5).

3. The Court subsequently granted several motions to expand the scope of the receivership to include other entities owned or controlled by Defendant Arthur Nadel ("Nadel") or otherwise funded with proceeds of the fraudulent scheme underlying this case. (SOUF ¶ 6).

4. On April 20, 2010, the Receiver filed his Unopposed Motion to (1) Approve Procedure to Administer Claims and Proof of Claim Form, (2) Establish Deadline for Filing Proofs of Claim, and (3) Permit Notice By Mail and Publication and Incorporated Memorandum of Law (the "Claims Form Motion") (Doc. 390). (SOUF ¶ 7).

5. According to the Certificate of Service for the Claims Form Motion, neither the Genium Entities, Canrol, nor Fulcrum were served with the Claims Form Motion. (Doc. 390). Consequently, they did not have notice or an opportunity to object to the proposed proof of claim form and procedures for reviewing claims sought by the Receiver.

6. The following day, the Court entered an Order approving the Claims Form Motion in its entirety (Doc. 391). (SOUF ¶ 7).

---

[5] Fulcrum will hereinafter cite to paragraphs in the Statement of Undisputed Facts as "SOUF ¶___".

7. On June 4, 2010, the Receiver mailed Proof of Claim forms to all known claimants, including Canrol. (SOUF ¶ 9).

8. On September 1, 2010, the Receiver received a timely filed Proof of Claim from Canrol (on behalf of the Genium Entities) asserting a loss of $1,195,000.00 ("Claim 445"). (SOUF ¶ 10).

9. On February 8, 2011, the Receiver sent correspondence to Canrol requesting additional information regarding the beneficial owners of the interests underlying Claim 445. (SOUF ¶ 11).

10. On March 11, 2011, the Receiver received a revised Proof of Claim Form from Canrol which stated that Canrol was acting as nominee for the Genium Entities. (SOUF ¶ 12).

11. On June 10, 2011, the Receiver sent correspondence to Fulcrum indicating that while Claim 445 identified the Genium Entities as the beneficial owners, it did not also identify any individuals with a legal interest in the beneficial owners. The Receiver's letter further stated that should this requested information not be furnished, he intended to recommend disallowance of Claim 445. (SOUF ¶ 14).

12. On June 13, 2011, Fulcrum contacted the Receiver and indicated that it would produce the additional information sought by the Receiver (identity of the individuals with a legal interest in the Genium Entities) if the Receiver would enter into a confidentiality agreement or obtain a protective order that would limit public disclosure of this information.[6] (SOUF ¶ 15).

[6] The Receiver himself demanded that Fulcrum enter into a similar agreement in connection with production of similar information requested by Fulcrum in this litigation. Recognizing the sensitive nature of information relating to the identity of claimants in this case, Fulcrum readily executed the confidentially agreement proposed by the Receiver.

13. Fulcrum repeatedly followed up on its offer to provide the Receiver with the information he was seeking subject to a confidentiality agreement on June 14, 2011, June 21, 2011, and June 28, 2011. Fulcrum received responses on June 14 and June 21, 2011 that the Receiver was considering Fulcrum's request and would revert shortly. The Receiver finally responded on June 28, 2011 that the time for providing the information he sought – most recently just eighteen days earlier- had long since passed and that he would make a determination based on the information in his possession. (SOUF ¶¶ 16 and 17).

14. On December 7, 2011, the Receiver filed his Unopposed Motion to (1) Approve Determination and Priority of Claims, (2) Pool Receivership Assets and Liabilities, (3) Approve Plan of Distribution, and (4) Establish Objection Procedure (the "Claims Determination Motion") (Doc. 675). In relevant part, the Claims Determination Motion recommended denial of Claim 445 because Canrol had failed to provide the full name of the entity and all of its trustees, officers, directors, managing agents, shareholders, partners, beneficiaries, and any other party with interest in the entity. (SOUF ¶ 18).

15. Exhibit G to the Claims Determination Motion further stated with respect to Claim 445:

> The director of an investment fund returned an Amended Proof of Claim identifying two investment funds as entities with an interest in this account, but stated that he would not provide the names of the trustees, officers, directors, managing agents, shareholders, partners, beneficiaries, or any other party with an interest in the entities. The Claimant's failure and refusal to provide the requested information has impeded the Receiver from assessing whether the Claimant has submitted an allowable claim. Because the Receiver cannot be sure that the beneficial owners of this account did not hold other Investor Accounts, receive False Profits in connection with such other accounts, otherwise receive additional money from Receivership Entities, or were not "insiders," this claim should be denied.

(SOUF ¶ 19).

16. On December 30, 2011, in response to the Receiver's recommendation in the Claims Determination Motion, Fulcrum emailed Receiver's counsel lists of shareholders for the Genium Entities. (SOUF ¶ 20).

17. On December 30, 2011, Receiver's counsel responded to this production by stating that the claims determinations were complete and that the Receiver would not engage in any discussions relating to the objections until an objection procedure was in place. (SOUF ¶ 21).

18. On March 2, 2012, the Court entered an Order granting the Claims Determination Motion (the "Claims Order") [Doc. 776]. The Claims Order directed any claimant wishing to object to the determination of a claim to submit a written objection to the Receiver by March 27, 2012. (SOUF ¶ 23).

19. On March 6, 2012, the Receiver received a timely objection from Fulcrum objecting to his determination of Claim 445 (the "Objection"). With the claims procedure now in place, Fulcrum again provided the Receiver with the list of shareholders of the Genium Entities, as it had done two months earlier and had been attempting to do so for almost nine months. Through the Objection, Fulcrum requested that the Receiver deem any purported defect in Claim 445 cured. (SOUF ¶ 24).

20. On April 27, 2012, the Receiver filed an Unopposed Motion to (1) Approve First Interim Distribution, (2) Establish Reserves, and (3) Approve Revisions to Certain Claim Determinations (the "Distribution Motion") [Doc. 825].

21. Pursuant to the Distribution Motion, the Receiver sought to reserve 20% of the claimed amount on Claim 445.

22. On May 7, 2012, the Court entered an Order granting the Distribution Motion [Doc. 839].

23. On August 15, 2012, the Receiver served on Fulcrum the Receiver's Response to Objection Relating to Determination of Claim 445 (the "Receiver's Response"). The Receiver's Response argues that Claim 445 should be denied because: (i) Fulcrum failed to provide the requested information regarding the beneficial owners of Claim 445; (ii) the information provided by Fulcrum still does not satisfy the Receiver's curiosity regarding the holders of Claim 445; (iii) the Genium Entities' status as sophisticated, institutional investors, as determined by the Receiver, warrants denial of Claim 445 as a matter of law; and (iv) even if Claim 445 is allowed, it should be equitability subordinated to claims of non-institutional investors as a matter of law because of the Genium Entities' status as "sophisticated institutional investor[s]". (SOUF ¶ 25).

24. On November 14, 2012, the Receiver filed an Unopposed Motion to (1) Approve Second Interim Distribution, (2) Approve Revisions to Certain Claim Determinations, (3) Increase Certain Reserves, and (4) Release Other Certain Reserves (the "Second Distribution Motion") [Doc. 945].

25. Pursuant to the Distribution Motion, the Receiver sought to reserve an additional $200,162.50 – 16.75% of the claimed amount; and a percentage equal to the proposed distribution on other Class 1 Claims – on Claim 445.

26. On November 16, 2012, the Court entered an Order granting the Second Distribution Motion [Doc. 946].

27. In reserving $439,162.50 for Claim 445 in connection with the first two interim distributions – 36.75% of the claimed amount – the Receiver has ensured there will be no prejudice to the Receivership estate or other creditors once Claim 445 is properly allowed.

ARGUMENT

I. CLAIM 445 WAS TIMELY AMENDED BY CANROL AND FULCRUM

Claim 445 was timely submitted by Canrol on September 1, 2010. The Receiver does not claim that Canrol did not timely file its proof of claim, or that the proof of claim did not sufficiently provide the Receiver notice of the amount of and basis for the claim. The only issue the Receiver has identified with Claim 445 in support of his position that it should be disallowed is that the list of beneficial owners of the claimant were not provided to his satisfaction.[7]

The Receiver's Response ignores case law supporting amendment of timely filed claims. District Courts serve as courts of equity in federal receiverships; likewise, bankruptcy courts are courts of equity. *See, S.E.C. v. Elliot*, 953 F.2d 1560, 1566 (11th Cir. 1992); *In re Int'l Horizons, Inc.*, 751 F.2d 1213, 1216 (11th Cir. 1985). The goal in both securities-fraud receiverships and liquidation bankruptcy is identical—the fair distribution of the liquidated assets. *In re Envirodyne Indus.*, 79 F.3d 579, 583 (7th Cir. 1996). Securities receiverships share many similarities with bankruptcy actions and courts have looked to bankruptcy law and code sections to resolve issues in these receiverships. *See, SEC v. First Securities of Chicago*, 507 F.2d (7th Cir. 1974); *S.E.C. v. Investors Security Leasing Corp.*, 476 F. Supp., 837,842 (W.D. Pa. 1979); *S.E.C. v. Elmas Trading Corp.*, 85 B.R. 116 (D. Nev. 1987). The United States Court of Appeals itself recently reiterated the similarity between the bankruptcy claims process and the claims

[7] In the Receiver's Response to the Objection, the Receiver for the first time argues that Claim 445 should also be denied solely because the Genium Entities were sophisticated, institutional investors. The Receiver did not raise this objection to Claim 445 in the Claims Determination Motion. The Receiver has only asserted this objection as to five of the over five hundred claims filed in the case and now, belatedly, a sixth claim, Claim 445.

process in SEC receivership proceedings such as this one. *See Bendall v. Lancer Management Group, LLC*, 2013 WL 3441101, *2 (11th Cir. July 9, 2013) (finding that "[g]iven that a primary purpose of both receivership and bankruptcy proceedings is to promote the efficient and orderly administration of estates for the benefit of creditors, we will apply cases from the analogous context of bankruptcy law, where instructive, due to limited case law in the receivership context").

As a court of equity, this Court must not allow substance to give way to form and ensure that technical considerations do not prevent justice from being done. *Pepper v. Litton*, 308 U.S. 295, 305, 60 S.Ct. 238, 244, 84 L.Ed. 281 (1939). Consistent with the principle of equity that guides bankruptcy and receiverships, it is well-established that amendments to claims should be freely permitted, and an amendment that does not create a new or additional claim may be filed after the expiration of normal time limits. *See, Int'l Horizons, Inc.*, 751 F.2d at 1216. *Woburn Assocs. v. Kahn (In re Hemingway Transp. Inc.)*, 954 F.2d 1 (1st Cir. 1992); *In re Unroe*, 937 F.2d 346 (7th Cir. 1991); *In re Dietz*, 136 B.R. 459 (Bankr. E.D. Mich. 1992); *In re Walls & All, Inc.*, 127 B.R. 115 (W.D. Pa. 1991).

In the Eleventh Circuit, *Int'l Horizons, Inc.* sets forth the standard for amendment to claims, stating that "amendment to a claim is freely allowed where the purpose was to cure a defect in the claim as originally filed, to describe the claim with greater particularity or to plead a new theory of recovery on the facts set forth in the original claim." *Int'l Horizons, Inc.*, 751 F.2d at 1216. Further, "amendment is permitted only where the original claim provided notice to the court of the existence, nature, and amount of the claim and that it was the creditors' intent to hold the estate liable." *Id.* at 1217. In allowing free amendment of claims, the *Int'l Horizons* court recognized the importance of finality that bar dates provide in liquidation situations. However,

the court of appeals also acknowledged the balance between this finality and allowing liberal post-bar date amendment of claims, and instructed courts to carefully analyze post-bar date amendments to ensure that the bar date is not vitiated by a creditor seeking to file a new claim under the guise of an amendment. *Id.* at 1216.

The Receiver does not dispute that the Genium Entities actually suffered the investment losses indicated in Claim 445. Instead, the Receiver argues that form should be elevated over substance by ignoring the general equitable rule in favor of amendment of pleadings in bankruptcy and receivership cases and disallowing Claim 445 as untimely because it did not provide all of the exhaustive discovery information the Receiver sought exactly when the Receiver sought it. The Receiver cannot plausibly argue that by supplementing or amending Claim 445 after the bar date, the Genium Entities or Fulcrum sought to assert a new claim in violation of the bar date. Claim 445 is, and has always been, a claim against Valhalla, as a result of the fraud perpetrated by Valhalla, for $1,195,000.00. The supplemental information – the list of those with an interest in the Genium Entities – does not impact the amount of the claim, the entity the claim was filed against, the basis for the claim, the nature of the claim, or the priority of the claim. Consequently, the amendment and supplementation of Claim 445 should be deemed allowed as provided, and Claim 445 should not be disallowed on the basis that it was not timely amended with the information sought by the Receiver.

Furthermore, allowing Claim 445 will not prejudice the Receiver or any other creditor of the Receivership Entities.[8] A court can consider whether post-bar date amendment of a claim is

[8] Of course, the allowance of an amended claim always "prejudices" other claimants, in that the pie available for distribution is cut into more pieces. But this is not the sort of undue prejudice that justifies disallowing a claim based on real losses on the grounds asserted by the Receiver; if it were, amendment of claims would never be allowed. Instead, a receiver or debtor must establish that amendment would prejudice the estate itself. *See In re Hawkins*, 2012 WL 3732807, *2 (Bankr. S.C. Aug. 27, 2012) ("Undue prejudice requires something more than requiring a debtor to pay a claim but may be demonstrated through evidence that allowance of the amended claim

appropriate if a party might be unduly prejudiced by the amendment to the claim. *Roberts Farms Inc. v. Bultman Operating Corp.*, 60 F.3d 1174 (5th Cir. 1995). However, no party will be prejudiced by allowing Claim 445. The Receiver was in possession of the supplemental information prior to any distribution being made to creditors in this case, and the Receiver has reserved an amount for Claim 445 equal to the percentage distributed to all other Class 1 claimants in anticipation of the allowance of Claim 445.

The Receiver further asserts that the supplemental information provided by Fulcrum does not completely cure the purported defect with Claim 445. It is the Receiver's position that Claim 445 should be denied because (i) the supplement information makes no reference to any purported interest holder in Genium Trading Company Ltd., (ii) the information provided does not provide detail regarding whether there has been any change in the beneficial owners of the Genium Entities; and (iii) the list of beneficial owners of the Genium Entities was not verified as complete and accurate under penalty of perjury. These three potential defects are insufficient to justify denial of Claim 445.

At this point, the Receiver, is not seeking a full proof of claim that might alert him to the nature and extent of the Genium Entities' investments and losses; he is seeking discovery. In the bankruptcy context, the documents required to assert a proof of claim by Bankruptcy Rule 3001 and Official Form 10 provide the debtor or trustee with enough information to determine whether or not a valid claim in the proper amount was filed. *In re Taylor*, 363 B.R. 303, 308 (Bankr. M.D.Fla. 2007), *citing, In re Armstrong*, 320 B.R. 97, 104 (Bankr. N.D. Tex. 2005). The purpose of Bankruptcy Rule 3001(c) is to provide the debtor with "fair notice of the conduct, transaction, and occurrences that form the basis of the claim." *In re Sandifer*, 318 B.R. 609, 611

---

would interfere with the orderly distribution to other creditors"). Such undue prejudice is absent here, where the instant dispute has had and cannot have any effect on distributions to other creditors.

(Bankr. MD. Fla. 2004). Claim 445, as filed, provides the Receiver ample opportunity to decide what transaction gave rise to the claim, whether the claim is valid, and whether the claim was asserted in the proper amount. The Receiver, has prudently sought to ascertain whether any of the Genium Entities were insiders of the Receivership Estates in connection with his analysis of Claim 445. The initial delay in providing this information to the Receiver, however, is not fatal to the allowance of Claim 445; it is grounds for a threatened, or actual, objection to the claim and then informal, or formal, discovery to resolve this issue. In bankruptcy cases, the filing of an objection to a proof of claim creates a contested matter, which provides the opportunity for parties to seek discovery pursuant to Federal Rule of Bankruptcy Procedure 7026 and Federal Rule of Civil Procedure 26. *See In re Monetary Group*, 72 B.R. 378, 379 (M.D. Fla. 1987). As Fulcrum has provided the Receiver with the discovery he seeks, and will continue to supplement it if the Receiver deems it insufficient, the Receiver's objection to Claim 445 on this issue should be overruled.

II. THE GENIUM ENTITIES' STATUS AS "INSTITUTIONAL" INVESTORS HAS NO IMPACT ON THE VALIDITY OF THEIR CLAIM OR THE DAMAGES THEY HAVE SUFFERED

The Receiver argues that the Genium Entities are sophisticated investors, while all other Class 1 claimants, save five exceptions, are not – and that this fact alone justifies disallowance of Claim 445. Specifically, the Receiver argues that this fact alone supports the conclusion that the Genium Entities were on actual or inquiry notice of the fraud, and therefore it would be inequitable to allow the Genium Entities' claim. This argument is entirely without merit. Even if the Genium Entities were distinct from the all other Class 1 claimants in sophistication, that would not be relevant to the Court's decision of whether to allow Claim 445.

The Receiver does not deny that the Genium Entities made real investments and suffered real, cognizable damages from Nadel's fraud in the amount sought in Claim 445. These injuries are compensable from the assets of the Receivership estate. Furthermore, the Genium Entities are precisely the type of victims the receivership process was instituted to protect. The Genium Entities invested in what they believed was a legitimate hedge fund and received no payments of principle or interest from the Receivership Entities in the few short months before they lost their entire investment. Certainly the Genium entities' investment just a few months before the fraud was discovered, without any profit-taking, does not evidence any kind of insider information or knowledge on the part of the Genium Entities.

The Genium Entities, like other investors of various level of skill and sophistication, were defrauded by the Receivership Entities and now rely on the Receiver to recover funds from Nadel and investors who received false profits; however, due to the Receiver's refusal to accept the discovery that Fulcrum has provided in connection with Claim 445, time and resources of the Receivership Estate have been needlessly dissipated and the recovery for all similarly situated victims has been diminished as a result.

The Genium Entities timely filed a proof of claim, have amended the claim, and have continued to seek to provide the Receiver with the information he has requested to alleviate any concern the Receiver may have about whether the Genium Entities were insiders of the Receivership Entities.

The Receiver attempts analogize the litigation of Claim 445 to fraudulent transfer cases but this analogy fails. In the fraudulent transfer cases cited by the Receiver, a party received transfers from an entity in a receivership or bankruptcy proceeding and, in seeking to retain those transfers, asserted the affirmative defense they had provide value for the transfers and received

the transfers in good faith. The cases cited in Section III of the Receiver's Response for the proposition that good faith is relevant deal with defendants seeking to retain a transfer from a bankrupt or receivership entity or claims asserted against a bankrupt or receivership entity by an insider actively involved in the fraud. None of these cases are applicable to the allowance of Claim 445, a claim filed by entities who received no transfers from the Receivership Entity and did not play any role in the fraudulent scheme. Therefore, the Genium Entities have no burden to prove they provided value and acted in good faith to seek to retain transfers that they never received from Valhalla.

The Genium Entities did not receive any transfers from the Receivership Entities and are not subject to fraudulent transfer or clawback litigation. The Genium Entities invested $1,195,000.00 in Valhalla and a few months later their entire investment vaporized. (In attempting to recover this loss, the Genium Entities asserted a claim against Valhalla for the amount of its loss. Courts have recognized that defrauded investors have a claim for fraud arising at the time of the initial investment. *Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011); *Jobin v. Mckay (In re M&L Business Mach. Co. Inc.)*, 84 F.3d 1330, 1342 (10th Cir. 1996) (noting that courts have allowed a "party fraudulently induced to enter into a contract to recover the full amount paid even when the defrauded party had acted negligently or had inquiry notice of the fraud.")). The Genium Entities' good faith in making their investment in Valhalla, or lack thereof, is not an issue any more than it was for the hundreds of other victims whose claims, like the Genium Entities, matched the Net Investment Amount calculated by the Receiver.

The Receiver's position that Claim 445 should be denied because the Genium Entities were sophisticated, institutional investors that knew or should have known of the fraud has no basis in law.

III. "NO FAULT" EQUITABLE SUBORDINATION OF THE GENIUM ENTITIES' CLAIM IS INAPPROPRIATE

Finally, the Receiver seeks to subordinate Claim 445 below all other Class 1 claimants based solely on the Genium Entities' status as a sophisticated investor. As with the analysis in the preceding section, even if the Genium Entities were distinct from the all other Class 1 claimants in this regard, that would be irrelevant. Status alone does not justify equitable subordination of a real claim for real losses.

To effect a *pro rata* distribution, district courts supervising receiverships have the power to "classify claims sensibly." *SEC v. Enterprise Trust Co.*, 559 F.3d 649, 652 (7th Cir. 2009). Included in this power is "the authority to subordinate the claims of certain investors to ensure equal treatment." *SEC v. Wealth Mgmt. LLC,* 628 F.3d 323, 333 (7th Cir. 2010). The standard for equitable subordination was articulated in *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700-02 (5th Cir. 1977). In *Mobile Steel*, the Court determined that three conditions must be satisfied before the exercise of equitable subordination would be appropriate: "(i) the claimant must have engaged in some type of inequitable conduct; (ii) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (iii) equitable subordination of the claim must not be inconsistent with provisions of the Bankruptcy Act." *Id.* (internal citations omitted). "[C]lassic examples of the types of conduct which would justify subordination are (1) fraud, (2) breach of fiduciary duty, (3) unfair overreaching, or (4) mismanagement by insiders taking unfair advantage of corporate opportunities." *In re Matter of Powe*, 75 B.R. 387, 391 (Bankr. M.D. Fla. 1987). Moreover, "when an innocent party asserting a legitimate claim is not guilty of any of the conduct described, there is no basis and justification to subordinate the claim of this creditor." *Id.*

It also should be noted that the Receiver's assertion in the Receiver's Response that the courts have preferred individual investors to institutional investors in making distributions to victim of investment fraud is inapposite to this litigation. The Receiver cites to an unpublished decision in criminal forfeiture action – *U.S. v. Pearlman*, Case No. 6:07-cr-00097-GKS-DAB [Doc. 201] (M.D. Fla. 2008) - for the blanket provision that individual investors should be paid before institutional investors. The Receiver has not cited to precedent for such similar preference in SEC Receivership actions. Furthermore, the Receiver has not established that the Genium Entities were institutional investors; nor has the Receiver provided evidence that he has given priority to individual investors over institutional investors through the First and Second Distribution Motion.

The Receiver has not satisfied the equitable subordination standard. Specifically, the Receiver has not alleged inequitable conduct by the Genium Entities. The Genium Entities were victims of the fraud at the Receivership Entities and engaged in no inequitable conduct. The Genium Entities were invested in Valhalla for only a few months before they sought to redeem their investment and discovered that the investment was a total loss. Even if the Genium Entities had been on inquiry notice of the fraud, which they were not, and could have completed a diligent investigation into whether fraudulent activity was occurring at the Receivership Entities in four months, the Genium Entities' actions did nothing that injured other creditors of the Receivership Entities or placed itself in a position of advantage.[9]

[9] For example, equitable subordination can be used to promotes fairness by preventing a redeeming investor from jumping to the head of the line and recouping 100 percent of his investment by claiming creditor status while similarly situated nonredeeming investors receive substantially less. *See Elliott*, 953 F.2d at 1569. This example, the exact opposite of the Genium Entities' situation, illustrates the type of claims the Receiver should be seeking to equitably subordinate – one where an investor successfully redeemed its investment to the determent of non-redeeming investor, like the Genium Entities.

WHEREFORE, for the foregoing reasons, Fulcrum respectfully requests that this Court enter an Order: (i) allowing Claim Number 445 in the full filed amount of $1,195,000.00 not subject to any further objection, reduction, or subordination; (ii) directing the Receiver to make all distributions on Claim 445 to its current owner – Fulcrum; (iii) directing the Receiver to release the reserved distributions for Claim 445 to Fulcrum immediately; (iv) directing the Receiver to remit future distributions on par with Class 1 Claimants to Fulcrum; and (v) for all further relief that this Court deems just and proper.

Dated: July 31, 2013
Miami, Florida

Respectfully Submitted,
HUNTON & WILLIAMS, LLP
Counsel for Fulcrum Distressed Opportunities Fund I, LP
1111 Brickell Avenue - Suite 2500
Miami, FL 33131
Tel: (305) 810-2500
Fax: (305) 810-2460

/s/ Kevin M. Eckhardt
Kevin M. Eckhardt (FBN 412902)
Matthew Mannering (FBN 39300)

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on July 31, 2013, I electronically filed the foregoing with the Clerk of Court using CM/ECF. I also certify that the foregoing document is being served this day on all counsel of record or *pro se* parties via transmission of Notice of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties who are not authorized to receive electronically Notices of Electronic Filing.

/s/ Kevin M. Eckhardt
Kevin M. Eckhardt