Securities and Exchange Commission v. Nadel et al Doc. 1051

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;
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.
_______________________________________/

THE RECEIVER'S RESPONSE IN OPPOSITION TO 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

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Burton W. Wiand, as Receiver, opposes Fulcrum Distressed Opportunities Fund I, LP's ("**Fulcrum**") objection to the Court's determination of Claim Number 445 (the "**Objection**"). Fulcrum sets forth the grounds for its Objection in its Memorandum of Law in Support of its Objection to the Receiver's Proposed Treatment of Claim Number 445 (the "**Objection Memorandum**") (Doc. 1048). Significantly, these proceedings are governed by equity, which includes treating similarly situated investors alike,[1] but Fulcrum admittedly never invested in any Receivership Entity. Instead, Fulcrum is an investment fund that acquired Claim Number 445 ("**Claim 445**") from another sophisticated, institutional, investment professional that invested in Arthur Nadel's scheme,[2] and Fulcrum's sole goal is to profit from the scheme's financial devastation by speculating that what it paid for the claim is substantially less than what the Receiver's efforts will yield.

Claim 445 was submitted by – and the investment in the scheme underlying it was made by – Canrol Finance Limited ("**Canrol**") as nominee for the account of two investment funds: Genium AI Fund Series 1 Ltd. Standard Portfolio and Genium Trading Company Ltd. (collectively, "**Genium**"). *See* Jt. Statement, Exs. C, E. On March 2, 2012, the Court approved the Receiver's denial of that claim (*see* Doc. 776), and on March 6, 2012, the Receiver received an objection to the claim determination from Fulcrum (*Id.* at Ex. R). The

[1] *See*, *e.g.*, *Quilling v. Trade Partners, Inc.*, 2006 WL 3694629, *1 (W.D. Mich. 2006); *S.E.C. v. Homeland Commc'ns. Corp.*, 2010 WL 2035326, *2 (S.D. Fla. 2010) ("[I]n deciding what claims should be recognized and in what amounts, the fundamental principle which emerges from case law is that any distribution should be done equitably and fairly, with similarly situated investors or customers treated alike....").

[2] *See* Joint Statement Of Undisputed Facts Relating To Objection To Determination Of Claim No. 445 at ¶ 20, Exs. N-O ("**Jt. Statement**") (Doc. 1038).

Receiver then served a response to the Objection detailing the reasons why Claim 445 should remain denied. *See* Jt. Statement Ex. S ("**Objection Response**"). Specifically, the Receiver explained the claim was properly denied because: (1) the claimant failed to comply with claims procedures and deadlines because it submitted a deficient claim and then refused to cure the deficiency; (2) the additional information eventually provided to the Receiver in an untimely fashion to try to cure still did not cure the deficiency; and (3) Genium was a sophisticated institutional investment professional and it either had inquiry or actual notice of Nadel's fraud. Further, the Receiver explained that if the Court ultimately may allow Claim 445 in whole or in part, it should be equitably subordinated to other investors' claims. Nothing in Fulcrum's Objection Memorandum warrants a different conclusion, and consequently its Objection should be overruled and Claim 445 should remain denied.

ARGUMENT

I. CLAIMANT BEARS THE BURDEN OF PROOF

Fulcrum argues the Receiver bears the burden of proof of demonstrating both the claim should remain denied and that it should be subordinated in the event it is allowed. In support, Fulcrum relies on Rule 3001(f) of the Federal Rules of Bankruptcy Procedure and two bankruptcy decisions. But this is a federal equity receivership, not bankruptcy, and Fulcrum ignores the explicit language of the Proposed Objection Procedure adopted by this Court to govern this very type of dispute. Since this is an equity receivership, bankruptcy rules and decisions do not govern. *See Quilling v. Trade Partners, Inc.*, 2007 WL 107669, *1 (W.D. Mich. 2007) ("This proceeding is a federal equity receivership and the Bankruptcy Code does not apply."); *S.E.C. v. Forex Asset Mgmt LLC,* 242 F.3d 325, 332 (5th Cir. 2001)

("[W]e need not rely on bankruptcy law for this non-bankruptcy case."); *S.E.C. v. Sunwest Mgmt., Inc.*, 2009 WL 3245879, *8 (D. Or. 2009) ("Federal equity receivership courts are not required to exercise bankruptcy powers and nor to strictly apply bankruptcy law."). Instead, the burden of proof was addressed in the Receiver's 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). Section V.A of that motion details the Proposed Objection Procedure through which the Court would review and resolve any outstanding objections to claim determinations, and subsection "(h)" states that "The Claimant shall have the burden of proof." On March 2, 2013, the Court granted that motion, finding the Proposed Objection Procedure was "logical, fair, and reasonable," and ordering that all objections to claim determinations be presented to the court in accordance with the Proposed Objection Procedure (Doc. 776). In short, the Proposed Objection Procedure under which this dispute has been presented to the Court places the burden of proof on Fulcrum.

Ultimately, the appropriate allocation of the burden of proof should not impact the resolution of the Objection. The Receiver and Fulcrum have filed the Joint Statement to set forth the undisputed facts upon which the Objection can be resolved, and for the reasons discussed in this response (and in the Receiver's Objection Response) those facts establish that Claim 445 should remain denied.

II. CLAIMANT DID NOT SUBMIT A COMPLIANT CLAIM BY THE DEADLINE, AND IT REFUSED TO CURE THE DEFICIENCY IN THE PROOF OF CLAIM FORM

In an April 21, 2010, Order (Doc. 391), the Court established a procedure to

administer claims and a Proof of Claim Form which required claimants to provide certain specified information. The bar date for filing completed Proof of Claim Forms was September 2, 2010. *See* Jt. Statement ¶ 8. On or about September 1, 2010, the Receiver received a Proof of Claim Form from Canrol claiming a loss of $1,195,000.00. *See id. ¶* 10, Ex. C. In response to question 17 of the Proof of Claim Form, Canrol indicated that it was its "client's decision to invest in this Fund," but Canrol did not provide the name(s) of or any other details about the client. *Id.* Ex. C.

On February 8, 2011, the Receiver sent correspondence to Canrol identifying deficiencies in the Proof of Claim Form. *See id.* ¶ 11, Ex. D. Essentially, the correspondence noted the investment underlying Claim 445 appeared to be a custodial arrangement, and consequently Canrol needed to provide information about the beneficial owner or owners of the investment. Specifically, the letter explained,

> As this appears to be a custodial account, you must identify the beneficial owner(s) of this account and any other parties with an interest in this account and specify the nature of each such person's or entity's interest. If the beneficial owner(s) is an entity, you must provide the information requested in question 3 of the Proof of Claim Form. Further, I require an original signature of an authorized beneficial owner on the submitted Proof of Claim Form certifying under penalty of perjury that the information provided on the Proof of Claim Form is true and correct for the beneficial owner(s) and the [pertinent] ... account.
>
> Alternatively, an officer of the Bank may provide a notarized document attesting to the following: (1) the identities of the beneficial owner(s) of the [pertinent] ... account and any other parties with an interest in the account; (2) the nature of the interest of each person or entity identified in (1); (3) the beneficial owner(s) agrees that the Exhibit A attached to the Proof of Claim Form accurately reflects the amount of the investment and all amounts received from that account <u>and any other funds</u> received from the Receivership Entities; (4) the beneficial owner(s) and/or any other interested parties have not commenced any litigation or other proceedings relating in any way to his/her investment as specified in question 12 of the Proof of Claim

> Form; and (5) the beneficial owner(s) and/or any other parties with an interest in the [pertinent] ... account did not receive anything of value other than money from any Receivership Entity at any point in time.

Id. Ex. D. The letter gave Canrol 30 days to supplement its Proof of Claim Form and warned that "failure to provide the original signature of an authorized beneficial owner or the notarized documentation requested [in the letter] ... may have an impact on your claim." *Id.*

On or about March 11, 2011, Canrol submitted a revised Proof of Claim Form which, for the first time, stated that Canrol was acting as nominee for the account of two Genium investment funds. *See id.* Ex. E. However, in response to Proof of Claim Form question 3, which, in relevant part, sought the identity of the persons or entities with an interest in Genium, Canrol stated in the revised form that Genium did "not intend to provide/disclose the requested information". *Id.*

Fulcrum's counsel, Kevin Eckhardt, later wrote to the Receiver attempting to "cure" the deficiency (*see id.* Ex. G), but he did so only (i) after he was informed by the Receiver that the Receiver intended to deny Claim 445 (*see id.*, ¶ 14, Ex. F) and (ii) on the condition that the Receiver enter into a confidentiality agreement (*see id.* ¶ 15, Ex. G). In response, on June 28, 2011, the Receiver informed Mr. Eckhardt that Canrol had not complied with the requirements for the submission of claims established by the Court, the time for submission of additional information had long since passed, and he would make a determination of Claim 445 based upon the information available at that time. *See id.*, ¶ 17, Ex. M.

On December 7, 2011, the Receiver filed his Claims Determination Motion (Doc. 675). In relevant part, that motion recommended denial of Claim 445, explaining that Canrol had failed and refused to provide requested information, which would have revealed the

beneficial owners of the investment underlying the claim and any other party with an interest in that investment. *See* Claims Determination Mot. at 23, Ex. G. As explained in that motion, the refusal to provide the requested information impeded the Receiver from determining whether Claim 445 should be allowed. On March 2, 2012, in relevant part the Court entered an Order granting the Claims Determination Motion as it relates to Claim 445 (Doc. 776). Further, the 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. On March 6, 2012, the Receiver received Fulcrum's Objection. *See* Jt. Statement ¶ 24, Ex. R.

As noted above, the Proof of Claim Form submitted by Canrol required it to, among other things, identify the beneficial owner (or owners) of the investment underlying Claim 445 and any other party claiming an interest in the investment. This information was requested from all similarly situated claimants, and it was important for several reasons, including for allowing the Receiver to determine whether Claim 445 should be allowed. Specifically, it was important for the determination of claims for several reasons. First, the same beneficial owner may have held multiple accounts with Receivership Entities, which in turn would have required the accounts to be "netted" so that any profits in an account would offset losses in another account. Second, the beneficial owner could have received money from Receivership Entities through transfers that were not specifically tied to the purported performance of the investment, such as in the form of "commissions" for referring other investors. Third, a beneficial owner could have been an "insider" in the scheme or a Receivership Entity, or otherwise in a position warranting a greater level of scrutiny, which in turn would have impacted that beneficial owner's right to receive distributions from the

Receivership estate. As discussed above, the pertinent information was not provided, and that deficiency was identified in a February 8, 2011, letter from the Receiver to Canrol. *See id.* Ex. D. That letter asked Canrol to correct the deficiency within thirty days, and warned that failure to provide the requested information could impact the claim.

Although in response Canrol submitted a revised Proof of Claim Form, it did not correct the noted deficiency. To the contrary, the revised Proof of Claim Form stated that Genium "[did] not intend to provide/disclose the requested information." *See id.* Ex. E. In other words, Canrol (and Genium) unequivocally refused to comply with the Court-approved procedures for submitting claims. This alone justified denial of Claim 445.

Three months later, and only after the Receiver informed Mr. Eckhardt that he intended to deny Claim 445 because of the deficiency, Mr. Eckhardt offered to disclose the list of beneficial owners of Genium on the condition the Receiver enter into a confidentiality agreement. *See id.* Ex. G. Because of the public nature of the receivership, the Receiver's obligations to present matters to the Court, and the burdens imposed by confidentiality agreements (especially if the Receiver was to have different agreements with different claimants), it was not feasible for the Receiver to agree to any confidentiality limitations. As a result, in a letter dated June 28, 2011, the Receiver iterated to Mr. Eckhardt that Canrol had failed to comply with the requirements established by court order for submitting claims, that the deadline for submitting additional information had long since passed, and that the Receiver would make a determination of Claim 445 based on the information available at that time. *See id.* Ex. M. Only after the Receiver filed his Claims Determination Motion, which in relevant part recommended denial of Claim 445, was a purported list of beneficial

owners of the investment underlying Claim 445 finally provided to the Receiver (*see id.* ¶ 21, Ex. P) – that list, however, is deficient and to date the deficiency has not been cured.[3]

Although Fulcrum attempts to minimize the significance of its, Canrol's, or Genium's refusal to timely provide necessary information, in reality it is a material and significant failure to comply with the claims procedures established by the Court. As an initial matter, in these proceedings equity requires that similarly situated investors be treated in a similar fashion. *See*, *e.g.*, *Quilling v. Trade Partners, Inc.*, 2006 WL 3694629, *1 (W.D. Mich. 2006); *Homeland Commc'ns. Corp.*, 2010 WL 2035326 at *2 ("[I]n deciding what claims should be recognized and in what amounts, the fundamental principle which emerges from case law is that any distribution should be done equitably and fairly, with similarly situated investors or customers treated alike...."). To achieve this, procedures and deadlines were established to uniformly apply to all claimants. Canrol, Genium, and Fulcrum failed to comply with those procedures and deadlines, yet they offered no reason whatsoever why they should be subjected to a different set of rules than all other similarly situated investors.

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[3] The list purports to identify the beneficial holders of the Genium investment funds which invested in the scheme through Canrol: Genium AI Fund Series 1 Ltd. Standard Portfolio and Genium Trading Company Ltd. *See* Jt. Statement Ex. P. In reality, however, the list does not cure the claim deficiency because it does not provide all (or necessarily any) of the relevant information. First, the list only references "Genium AI Fund Leveraged Portfolio" and "Genium AI Fund Standard Portfolio," and makes no reference to any purported interest holder in Genium Trading Company Ltd. Second, although the list purports to identify the current beneficial owners of the "Genium funds," neither the list nor the Objection states that any of the listed beneficial owners was also a beneficial owner at any point in time from when Genium invested in the scheme in the middle of 2008 until the scheme collapsed in late 2008 and early 2009. Third, and even ignoring these deficiencies with the list, no verification (under penalty of perjury as required by the Proof of Claim Form, or otherwise) was submitted to confirm the accuracy and completeness of that list. As such, the Objection should be overruled for this reason as well.

Notably, they unequivocally refused to comply with their obligations even after the Receiver provided them an additional 30 days to so. *See* Jt. Statement ¶¶ 11, 12, Exs. D, E. These deadlines and procedures are critical to bringing finality to the number and value of claims asserted so determinations can be made and assets distributed. Claimant here (1) failed to comply with the obligation to provide requested information by a deadline and (2) then rejected the same opportunity provided to other similarly situated claimants to provide the information by an extended deadline. As such, the Objection is implicitly premised on a belief that Claim 445 should be treated in a preferential manner; one which differs from the manner in which all other similarly situated claims were treated. Fulcrum, however, has provided no justification for this, and none exists. The preferential treatment sought is inconsistent with the equitable principles that govern this proceeding.[4] *Cunningham v. Brown*, 265 U.S. 1, 13 (1924) (as among "equally innocent victims, equality is equity.").

This Court recently underscored "the importance of establishing a fixed claims process procedure in a receivership case" when presented with a similar request from a claimant that sought to have an untimely claim recognized. *See* Order denying Motion of Claimant Elendow LLC to Modify Order Disallowing Claim (Doc. 1002). In that instance, a claimant served a Proof of Claim Form after the bar date, and the Receiver wrote to the

[4] Aside from being inequitable, the relief sought by Fulcrum is problematic for another reason. Fulcrum seeks to modify and supplement the information submitted for Claim 445 long after the claims bar date, and sustaining its Objection and allowing the modification and supplementation could undermine the finality and absolute nature of the claims bar date. So, for example, claimants holding allowed in part or denied claims could argue that they too should be allowed to supplement and modify their submissions. Notably, one of the very reasons that uniform deadlines and procedures are established, and claimants are required to comply with them, is to avoid these exact same issues.

claimant requesting an explanation for the late submission.[5] The Court rejected claimant's request to allow the untimely claim, finding that doing so "would highly prejudice the receivership." The Court concluded the claimant's circumstances were substantially different from those of claimants whose late-filed claims were allowed after those claimants provided in a timely fashion reasonable reasons for missing the bar date. *Id.* at 8. Finding that the request lacked any exceptional circumstances other than an extremely late attempt to challenge the denial of the claim, the Court denied the motion to recognize the claim.

The same considerations for denying that motion apply here. Canrol received the same opportunity to correct the deficiency in its Proof of Claim Form as other claimants who failed to provide requested information, and Canrol also was warned that failure to comply could have a detrimental impact on its claim. In response, unlike other claimants, Canrol chose not to provide the requested information and affirmatively stated that it did not intend to comply with the Receiver's request. Not until almost a year later did Fulcrum attempt to correct the deficiency by providing information to the Receiver, and significantly it did so three weeks after the Receiver filed his Claims Determination Motion in which he disclosed his recommendation that Claim 445 be denied. Notably, the information Fulcrum provided still did not cure the deficiencies and they remain uncured. These facts undermine Fulcrum's characterization that it timely amended Claim 445, and show the requested information was not of a clerical or otherwise insignificant nature, but instead was important. In short, Claim 445 has been properly denied.

[5] That claimant asserted that he mailed a response to the Receiver's letter approximately six months after receiving it, but the Receiver never received a response.

III. GENIUM'S STATUS AS A PROFESSIONAL, INSTITUTIONAL INVESTOR WARRANTED DENIAL OF ITS CLAIM

Even assuming *arguendo* (i) claimant's failure to comply with its deadlines and obligations with respect to the submission of Claim 445 is ignored and (ii) the additional information provided by Fulcrum cures the deficiencies, the Objection still should be overruled because the underlying holder of the investment – Genium – had actual or inquiry notice of fraud, and thus it would be inequitable to allow a claim based on Genium's investment. Specifically, Genium was a sophisticated institutional investment professional (*see* Jt. Statement ¶ 26) and, at a minimum, should have recognized at least some of the numerous and easily discernible "red flags" surrounding Arthur Nadel, the Receivership Entities, and the purported investment opportunities underlying this claim. In turn, it should have conducted a diligent and reasonable investigation, which would have uncovered fraud or, at a minimum, failed to ameliorate matters. As a result, Genium was, at a minimum, on inquiry notice of fraud. Importantly, this is the same treatment the Receiver recommended, and the Court adopted, for other institutional investment professionals.

District Courts sit as courts of equity over federal receiverships. *See, e.g.*, *S.E.C. v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992). As such, the Court has "broad powers and wide discretion" to fashion appropriate relief, including in devising a plan for distribution of receivership assets. *See, e.g., id.* In resolving claims submitted in a claims process, courts consider a wide variety of factors with the ultimate goal of fashioning an equitable system that treats similarly situated claimants equally. *See, e.g., Homeland Commc'ns. Corp.*, 2010 WL 2035326 at *2 ("[I]n deciding what claims should be recognized and in what amounts, the fundamental principle which emerges from case law is that any distribution should be

done equitably and fairly, with similarly situated investors or customers treated alike....") (quotation omitted); *Cunningham*, 265 U.S. at 13 (as among "equally innocent victims, equality is equity"); *Elliot,* 953 F.2d at 1570 (same). One consideration is whether the claimant acted in "good faith" or, put differently, whether the claimant knew or should have known of fraud. *See, e.g., SEC v. Megafund Corp.*, 2007 WL 1099640, *2 (N.D. Tex. 2007) (claims disallowed because claimants did not show they acted in good faith).

In pertinent part, the concept of good faith derives from fraudulent conveyance statutes, including the Florida Uniform Fraudulent Transfer Act, Fla. Stats. §§ 726.101 *et seq.* ("**FUFTA**"). Under FUFTA, the Receiver may recover transfers for the benefit of the Receivership estate that were made with "actual intent to hinder, delay, or defraud" creditors (Fla. Stats. § 726.105(1)(a)), which intent is established as a matter of law when a transfer is made during a Ponzi scheme. *See, e.g.*, *In re Christou*, 2010 WL 4008191, *3 (Bankr. N.D. Ga. 2010) ("Any transfers made during the course of a Ponzi scheme are presumptively made with intent to defraud."); *Wing v. Horn*, 2009 WL 2843342 at *4-5 (D. Utah 2009) ("[I]nference of fraudulent intent applies to all transfers from a Ponzi scheme"; categorizing transactions "is inconsistent with fraudulent transfer law's focus on the transferor"); *Quilling v. Schonsky*, 247 Fed. App'x 583, 586 (5th Cir. 2007) ("[T]ransfers made from a Ponzi scheme are presumptively made with intent to defraud . . . ."); *Warfield v. Byron,* 436 F.3d 551, 558 (5th Cir. 2006) (same). FUFTA provides an affirmative defense, however, under which the Receiver may not recover a transfer if the transferee can demonstrate: (1) that it received the transfer in "good faith" and (2) that it provided reasonably equivalent value for the transfer. *See* Fla. Stats. §§ 726.109(1), (2)(b).

Consistent with this equitable principal that claimants who cannot satisfy the good faith standard should have their claims denied, in his "clawback" lawsuits against sophisticated investors who knew or should have known of fraud, the Receiver has tailored his FUFTA claims to require those defendants to show they satisfied the good faith standard. *See, e.g.*, *Wiand, as Receiver v. Buhl,* Case No. 8:10-cv-00075-T-17MAP (M.D. Fla.)*;* *Wiand, as Receiver v. EFG Bank et al.,* 8:10-cv-00241-T-17MAP (M.D. Fla.). Specifically, rather than presuming those defendants acted in good faith, the Receiver has sought to recover <u>all</u> transfers received by them from Nadel's scheme, thus requiring them to prove, *inter alia*¸ their respective good faith before being allowed to keep an amount of distributions equivalent to their principal investment. *See, e.g., Forte*, 2010 WL 939042 at *6 ("If a winning investor should have known [his] or her investment was 'too good to be true,' the court will void the return of principal to that investor. That principal will then be redistributed *pro rata* to all defrauded investors.").

Just as "winning" investors (*i.e.*, investors who received more than they invested, or so-called "False Profits") who cannot satisfy the good faith standard are not entitled to retain any distributions they received under FUFTA, it would be inequitable to distribute Receivership assets based on investments made by investors, like Genium, that cannot satisfy the good faith standard. *See CFTC v. PrivateFX Global One*, 2011 WL 888051, *9-10 (S.D. Tex. 2011) ("Sitting in equity, the district court is a court of conscience.") (quotations omitted); *S.E.C. v. Sunwest Mgmt., Inc.*, 2009 WL 3245879, *9 (D. Or. 2009) ("In approving a plan of distribution in an SEC receivership case, the court must determine the most equitable distribution result for all claimants, including investors."); *Megafund Corp.*, 2007

WL 1099640 at *2 (overruling objection to magistrate's recommendation that claim be denied due to claimant's lack of good faith).

Good faith is an objective standard. *See Terry v. June*, 432 F. Supp. 2d 635, 641 (W.D. Va. 2006). "The relevant inquiry is what the transferee objectively knew or should have known instead of examining the transferee's actual knowledge from a subjective standpoint." *See Quilling v. Stark*, 2007 WL 415351, *3 (N.D. Tex. 2007). "[I]f the circumstances would place a reasonable person on inquiry notice of a debtor's fraudulent purpose, and *diligent* inquiry would have discovered the fraudulent purpose, then the transfer is fraudulent." *In re World Vision Entertainment, Inc.*, 275 B.R. 641, 659 (Bankr. M.D. Fla. 2002). "Importantly, a transferee may not remain willfully ignorant of facts which would cause it to be on notice of a debtor's fraudulent purpose, and then put on 'blinders' prior to entering into transactions with the debtor and claim the benefit of [the good faith defense]." *Id.* (internal citations and quotations omitted). In turn, a diligent inquiry "must ameliorate the issues that placed the transferee on inquiry notice in the first place" and cannot consist of merely inquiring with the transferor about the suspicious circumstances. *In re Bayou Group*, 396 B.R. 810, 846 (Bankr. S.D.N.Y. 2008). In short, if an investor's reasonable conduct would have revealed any questions or concerns about any Receivership Entity or Nadel or anyone else associated with a Receivership Entity, that investor could not have acted in good faith unless it subsequently conducted a diligent and reasonable inquiry which ameliorated those questions or concerns. Without satisfying these obligations, the investor was on inquiry notice of fraud.

As noted above, Genium was a sophisticated institutional investment professional,

and it was experienced and knowledgeable about investing, reasonable investment practices, and realistic investment performance. Had it acted in a manner that was reasonable and diligent for its sophistication, experience, and knowledge, it would have easily discovered or recognized red flags, which in turn would have required it to further investigate Nadel, Receivership Entities, and the purported investment opportunity. Had it complied with these obligations, Genium would have readily discovered fraudulent conduct. Given the numerous and easily discoverable red flags, Genium did not act in good faith. *See, e.g., In re Pearlman*, 440 B.R. 569, 577 (Bankr. M.D. Fla. 2010) (lenders to Ponzi scheme that ignored red flags did not act in good faith); *S.E.C. v. Basic Energy & Affiliated Res.,* 273 F.3d 657, 660 (6th Cir. 2001) (affirming distribution plan that prohibited defendants from recovering at all, and reduced recovery of employees based on level of involvement in fraudulent scheme).

Here, the red flags were numerous and easily discoverable. For example, before perpetrating the scheme,

- Nadel had been disbarred from the practice of law in New York State for engaging in "dishonesty, fraud, deceit and misrepresentation" by misusing money that had been deposited in his escrow account.

That determination was made in a published opinion. *See* Jt. Statement ¶ 27. Further, the following relevant information was in the public records of Sarasota County – the same county in which Nadel, the Hedge Funds, and almost all other Receivership Entities were based:

- Nadel had at least eight money judgments entered against him in Sarasota County courts for failure to pay amounts owed (*Id.* ¶ 28); and

- Nadel had gone through a divorce in which in publicly filed

> documents he: was alleged to have defrauded "numerous individuals and/or businesses;" swore he was a "self employed" "musician" and later unemployed, had monthly gross income of $889.00 and later none, had monthly expenses of $2,894.00, had total assets of $1,650.00 and later of only $1,000.00, and had total liabilities of $129,075.00; and he otherwise represented to the court that he was "financially impoverished" and had "no assets, no liquidity, no money in the bank, and no resources of any kind" (*Id.* ¶¶ 29-30).

There were also many other red flags directly connected to the Hedge Funds, including the following:

- The consistently high reported rates of return, including the fact that marketing materials showed the Hedge Funds never reported a single quarter with a negative return and only had five months of reportedly negative returns over the span of almost ten years, and those months were barely negative;

- For the nearly 8 years during which Valhalla Investment Partners, L.P., was in existence before the investment underlying this case, that fund only reported 4 months with a negative return (and the biggest decline was only -1.30%) – in contrast, the S&P index had 42 months of negative returns during the same period;

- Marketing materials and statements sent to Canrol/Genium showed the Hedge Funds reported unusually high investment returns - for example, they reported yields between 11.43% and 55.12% per year, and in most years between 20% and 50%;

- The Hedge Funds' reported returns were implausible in light of the types of securities and trading strategy that Nadel purportedly used;

- The Hedge Funds were not audited;

- Nadel had no previous experience as an investment adviser;

- The Hedge Funds did not employ the types of professionals with appropriate skills and experience needed to operate a successful hedge fund;

- The Hedge Funds purported to be operated in an identical manner, to have identical trading strategies, and to trade securities collectively

through a master trading platform, each of which raised integration issues and violations of federal securities laws, including the 100-investor limit imposed by Section 3(c)(1) of the Investment Company Act of 1940 for exemption from registration;

- As the Hedge Funds' marketing materials and the statements Canrol/Genium received showed, even though the various Hedge Funds purportedly had the same investment strategy, their purported rates of return differed;

- Nadel was not registered as an investment adviser under the Investment Advisers Act of 1940 even though the exemptions from registration were not satisfied as a result of a number of factors, including the manner in which investors were solicited and the way Nadel was represented to the investing public;

- The Hedge Fund offerings were not registered under the Securities Act of 1933 even though the exemptions from registration were not satisfied as a result of a number of factors, including the manner in which investors were solicited, the Hedge Funds' integration issue, and the presence of unaccredited investors;

- The Hedge Funds were not registered as investment companies under the Investment Company Act of 1940 even though the exemptions from registration were not satisfied as a result of a number of factors, including the Hedge Funds' integration issue noted above, the nature of the investors, and the manner in which investors were solicited; and

- The Hedge Funds' purported accountant had been misidentified as a "CPA" - in reality, his license had been "null and void" since 1989. Further, he had been the subject of an investigation and a cease and desist notice from state regulators for improperly identifying himself as a CPA, all of which information was publicly available (*Id.* ¶ 31).

Because Genium would have discovered red flags had it acted in a reasonable and diligent manner, it was on inquiry notice of fraud. *In re Old Naples Secs., Inc.,* 311 B.R. at 612-13; *In re Manhattan Inv. Fund Ltd*., 397 B.R. 1, 23 (S.D.N.Y. 2007) (sophisticated claimant cannot claim ignorance to support its argument that it acted in good faith); *In re M & L Business Machine Co*., 84 F.3d at 1330, 1339 (10th Cir. 1996) (experienced investor

should have realized excessive annual returns as a red flag, and acted in accordance with such information). In short, Claim 445 should remain denied also because Genium failed to act in good faith and thus it would be inequitable to distribute any Receivership assets based on Genium's investment. As such, also for this reason the Objection should be overruled.

Although Fulcrum claims the Receiver's position "has no basis in law," the above citations show that is not accurate. Further, as a court of equity presiding over these matters, the Court has "broad powers and wide discretion" to fashion appropriate relief, including in devising a plan for distribution of receivership assets. *Elliott*, 953 F.2d at 1566. As such, the Court may consider a wide variety of factors with the ultimate goal of fashioning an equitable system that treats similarly situated claimants equally. *See, e.g., Homeland Commc'ns. Corp.*, 2010 WL 2035326 at *2 ("[I]n deciding what claims should be recognized and in what amounts, the fundamental principle which emerges from case law is that any distribution should be done equitably and fairly, with similarly situated investors or customers treated alike...."). Here, Genium's status as a sophisticated institutional investment professional, along with its experience and knowledge in investments, reasonable investment practices, and realistic investment performance warrants treatment in a manner different than far less sophisticated individual investors. In short, Claim 445 should remain denied also because Genium failed to act in good faith and thus it would be inequitable to distribute any Receivership assets based on Genium's investment.

IV. EVEN IF CLAIM 445 IS ALLOWED, EQUITY REQUIRES THAT IT BE SUBORDINATED TO CLAIMS OF NON-INSTITUTIONAL INVESTORS

Even assuming both the Proof of Claim Form deficiencies and Genium's status as an institutional investment professional are ignored, and Claim 445 is allowed, in terms of

priority the claim should be equitably subordinated to all Class 1 Claims.[6] As such, if the Objection is sustained and Claim 445 is allowed in any part, it should only be paid after all allowed amounts of all Class 1 Claims are paid in full.

Plans of distribution of receivership assets to victims of a scheme are governed by the fundamental principle that the plan should be equitable and treat similarly-situated investors alike. *U.S. v. Petters*, 2011 WL 281031, *7 (D. Minn. 2011). The power afforded to a district court supervising an equity receivership includes the authority to subordinate the claims of certain investors to ensure equal treatment. *S.E.C. v. Wealth Mgmt. LLC*, 628 F.3d 323, 333 (7th Cir. 2010). "Subordination is an equitable power and is therefore governed by equitable principles." *In re Westgate Cal. Corp.*, 642 F.2d 1174, 1177 (9th Cir. 1981). "Equitable subordination does not deal with the existence or non-existence of the debt, but rather involves the question of order of payment." *In re Lockwood,* 14 B.R. 374, 380–81 (Bankr. E.D.N.Y. 1981). "The fundamental aim of equitable subordination is to undo or offset any inequality in the claim position of a creditor that will produce injustice or unfairness to other creditors...." *Id.* (internal quotations omitted).

Here, investors holding Class 1 Claims were not sophisticated institutional investment professionals like Genium with the skill, experience, knowledge, and resources available to Genium for conducting reasonable due diligence. Because of its failure to act in a reasonable manner, Genium failed to identify (or, even worse, ignored) a multitude of red flags and to satisfy its diligence obligations. Had it acted appropriately, it would have uncovered fraud

[6] "**Class 1 Claims**" consist of all allowed and allowed in part claims submitted by investors in the scheme underlying this matter. *See* Claims Determination Mot. at 34.

or, at a minimum, failed to ameliorate concerns. As a result, Genium was, at a minimum, on inquiry notice of fraud, and placing Genium on par with claimants holding Class 1 Claims would be inequitable. *See 80 Nassau Assocs. V. Crossland Fed. Sav. Bank*, 169 B.R. 832, 837 (Bankr. S.D.N.Y. 1994) (even if inequitable conduct may be lawful, it can still shock good conscience and give rise to claim for equitable subordination) (quotations omitted).

Indeed, in other proceedings involving distributions to victims of investment fraud, courts have treated individual investors in a preferential manner as compared to institutional investors. As Fulcrum acknowledges, this judicial District recently adopted a similar approach in ordering that proceeds obtained from a forfeiture money judgment arising from a massive Ponzi scheme be returned to victims "with priority given to compensate individual investors fully prior to compensating institutional investors." *U.S. v. Pearlman*, Case No. 6:07-cr-00097-GKS-DAB, Forfeiture Money Judgment (M.D. Fla. 2008) (emphasis added). As such, even assuming *arguendo* Claim 445 was allowed, it nonetheless should be equitably subordinated to all Class 1 Claims and be paid only after all allowed amounts for Class 1 Claims are paid in full.

CONCLUSION

For the foregoing reasons, the Receiver respectfully requests that the Court overrule Fulcrum's Objection and affirm the determination that Claim Number 445 should be denied so that the $439,162.50 the Receiver has reserved for this claim can be distributed to investors who complied with their obligations in a timely fashion and are not here to profit like Fulcrum. In the alternative, to the extent that Claim 445 is allowed (in whole or in part), it should be subordinated to all Class 1 Claims.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on August 20, 2013, I electronically filed the foregoing with the Clerk of Court by using the CM/ECF system.

I FURTHER CERTIFY that on August 20, 2013, a true and correct copy of the foregoing was sent via first-class mail delivery to the following non-CM/ECF participant(s):

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