Securities and Exchange Commission v. Nadel et al

Doc. 1128 Att. 3

Exhibit 3

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IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

Case No. 14-11203-D

BURTON W. WIAND, as Receiver for Valhalla Investment Partners, L.P.; Viking Fund, LLC; Viking IRA Fund, LLC; Victory Fund, Ltd.; Victory IRA Fund, Ltd.; and Scoop Real Estate, L.P.,

Plaintiff-Appellant,

v.

ROBERTA SCHNEIDERMAN and ROBERT ZIMELIS, as Co-Executors of the ESTATE OF HERBERT SCHNEIDERMAN,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF FLORIDA

INITIAL BRIEF OF PLAINTIFF-APPELLANT BURTON W. WIAND, AS RECEIVER

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CERTIFICATE OF INTERESTED PERSONS AND CORPORATE DISCLOSURE STATEMENT

Appellant Burton W. Wiand, as Receiver for Valhalla Investment Partners, L.P.; Viking Fund, LLC; Viking IRA Fund, LLC; Victory Fund, Ltd.; Victory IRA Fund, Ltd.; and Scoop Real Estate, L.P. (collectively, the "**Hedge Funds**"), by and through his undersigned counsel and pursuant to Fed. R. App. P. 26.1 and 11th Cir. R. 26.1-1, certifies that no publicly held corporation owns 10% or more of the Hedge Funds. Further, the Receiver submits this Certificate of Interested Persons:

1. Barlow, Mahlon H.
2. Kovachevich, Elizabeth A. (District Judge, Middle District of Florida)
3. Lamont, Michael S.
4. Lazzara, Richard A. (District Judge, Middle District of Florida)
5. Levenson, Robert K.
6. Masel, Scott A.
7. McCoun, III, Thomas B. (Magistrate Judge, Middle District of Florida)
8. Morello, Gianluca
9. Nadel, Arthur (Deceased)
10. Perez, Jared J.
11. Pizzo, Mark A. (Magistrate Judge, Middle District of Florida)

12. Sawczyn, C. Read
13. Schneiderman, Roberta
14. Scoop Capital, LLC
15. Scoop Management, Inc.
16. Scoop Real Estate, L.P.
17. Securities and Exchange Commission
18. Sivyer Barlow & Watson, P.A.
19. Valhalla Investment Partners, L.P.
20. Valhalla Management, Inc.
21. Victory Fund, Ltd.
22. Victory IRA Fund, Ltd.
23. Viking Fund, LLC
24. Viking IRA Fund, LLC
25. Viking Management, LLC
26. Wiand, Burton
27. Wiand Guerra King P.L.
28. Yip, Maria M.
29. Yip and Levi, LLC
30. Zamorano, Andre
31. Zimelis, Robert D.

STATEMENT REGARDING ORAL ARGUMENT

Plaintiff-Appellant Burton W. Wiand, as Receiver, requests oral argument, as this appeal concerns issues of first impression regarding arbitration pursuant to arbitration language in the "investment contract" (or security) at the heart of a massive Ponzi scheme. These issues will significantly impact federal equity receiverships.

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SUBJECT MATTER AND APPELLATE JURISDICTION

This is a direct appeal from a civil case. The Receiver filed this "clawback" case on January 19, 2010, in the United States District Court for the Middle District of Florida (the "**District Court**"). Doc.[1] 1. The District Court had subject matter jurisdiction pursuant to 15 U.S.C. § 78aa, 28 U.S.C. §§ 754 and 1692, and principles of ancillary or supplemental jurisdiction under 28 U.S.C. § 1367. As explained more fully in the Relevant Procedural History (*see infra* p. 1-4), the defendants in this and other related "clawback" cases filed motions to compel arbitration, which the District Court granted on September 29, 2011. *See* Docs. 42, 47. The Receiver attempted to appeal that order at that time, but this Court dismissed the appeal as interlocutory (*see* Doc. 57; 11th Cir. Case No. 11-15195-GG) and the District Court denied the Receiver's motion for leave to proceed with an interlocutory appeal (Doc. 60).

This case proceeded to arbitration, where the Receiver added Roberta Schneiderman as a defendant in her individual capacity. Roberta Schneiderman and Robert D. Zimelis, as Co-Executors of the Estate of Herbert Schneiderman, and Roberta Schneiderman, individually, are referred to collectively in this brief as the "**defendants**." On May 3, 2013, an arbitrator erroneously entered an award in favor of the defendants based on inapplicable probate statutes. *See* Doc. 62, Ex. A.

[1] "Doc." refers to the docket number of filings in the District Court.

On August 1, 2013, the Receiver filed in the District Court a motion to vacate the award, which consistent with the arbitration, also added Roberta Schneiderman as a defendant in her individual capacity (Doc. 61), but the District Court denied that motion (Docs. 70, 73). On March 19, 2014, the Receiver filed a timely notice of appeal of both the District Court's order compelling arbitration (Doc. 47) and its order refusing to vacate the arbitral award (Doc. 73). *See* Doc. 74.

ISSUES PRESENTED

1. Was arbitration of this "clawback" case to recover receivership property contrary to the congressional command to resolve disputes regarding receivership property in a single forum which is discernable from an "inherent conflict" between 28 U.S.C. §§ 754 ("**Section 754**") and 1692 ("**Section 1692**" and, collectively with Section 754, the "**Receivership Statutes**") on the one hand and arbitration on the other, so that arbitration was foreclosed by *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987), and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 627-28 (1985)?

2. Did the Scheme Offering Documents (as that term is defined below) come into existence as contracts with arbitration provisions where (1) there was no mutual assent between the parties under governing Florida law, (2) the manager of the Hedge Fund Victory Fund, Ltd. (like those of the other Hedge Funds) did not have the authority to bind it to the Scheme Offering Documents, and (3) the creation of Victory (like the other Hedge Funds) and the Scheme Offering Documents was *ultra vires*?

3. Did the Scheme Offering Documents come into existence as contracts with arbitration provisions where they were used solely to perpetrate an illegal Ponzi scheme, and in fact, were the very security at the heart of the scheme?

4. Did the District Court err by compelling arbitration of the Receiver's claims on behalf of each and every Hedge Fund when, even assuming the Scheme Offering Documents were contracts, the pertinent investor here undisputedly entered into a purported contract with only one Hedge Fund and, independently, the defendants here undisputedly never entered into a contract with any Hedge Fund?

5. Should the District Court have vacated the arbitrator's award in favor of the defendants because the arbitrator so imperfectly executed his powers that a mutual, final, and definite award upon the subject matter submitted was not made?

STATEMENT OF THE CASE

Relevant Procedural History

This is one of numerous "clawback" cases brought by the Receiver under the Florida Uniform Fraudulent Transfer Act, Fla. Stats. §§ 726.101 *et seq.* ("**FUFTA**"), and specifically under Fla. Stats. § 726.105(1)(a) ("**Section 726.105(1)(a)**"), against recipients of fraudulent transfers following a massive Ponzi scheme (the "**scheme**") perpetrated by Arthur Nadel ("**Nadel**"). *See generally S.E.C. v. A. Nadel et al.*, Case No. 8:09-cv-87-T-26TBM (M.D. Fla.) (the "**SEC Action**"); *United States v. A. Nadel.*, Case No. 1:09-cr-00433-JGK (S.D.N.Y.).

The Receiver brought this case in his capacity as court-appointed Receiver for each of the Hedge Funds.[2] On January 14, 2011, the defendants here (and those in several other of the Receiver's clawback cases) moved to compel arbitration based on purported arbitration clauses in a "**Limited Partnership Agreement**" and a "**Subscription Agreement**" that ostensibly governed investments in Hedge Fund Victory Fund, Ltd. ("**Victory**") (collectively, the "**Scheme Offering Documents**"). *See* Docs. 20, 21. The Receiver opposed that motion and argued *inter alia* that the Scheme Offering Documents did not reflect contracts that came

[2] Mr. Wiand was also appointed Receiver for Scoop Capital, LLC ("**Scoop Capital**"); Scoop Management, Inc. ("**Scoop Management**"); Valhalla Management, Inc. ("**Valhalla Management**"); and Viking Management, LLC ("**Viking Management**") (collectively, the "**Fund Managers**").

into existence because, among other reasons, they were used at all times to perpetrate and perpetuate a Ponzi scheme. *See* Docs. 25, 35. He also argued the District Court should not compel arbitration because of the congressional command against arbitration under these circumstances reflected in the inherent conflict between arbitration and the Receivership Statutes. *Id.*

On September 29, 2011, however, the District Court granted the motion to compel arbitration, concluding that *inter alia* (1) contracts reflected in the Scheme Offering Documents came into existence and (2) there was no inherent conflict between arbitration and the Receivership Statutes. *See* Docs. 42, 47; *In re Wiand*, 2011 WL 4530203, *10 (M.D. Fla. 2011). The Receiver attempted to appeal the District Court's order, but this Court dismissed the appeal as interlocutory (*see* Doc. 57; 11th Cir. Case No. 11-15195-GG) and the District Court denied the Receiver's motion for leave to pursue an interlocutory appeal (Doc. 60).

Left with no alternative, the Receiver filed a demand for arbitration against the defendants with the American Arbitration Association. On February 8, 2013, the Receiver filed in the arbitration proceeding a Motion For Declaratory Judgment That The Purported Agreements Containing Arbitration Clauses Are Void *Ab Initio* (the "**Declaratory Judgment Motion**"), which made arguments the District Court had held were "for the arbitrators to consider." Doc. 47 at 15. Specifically, the Declaratory Judgment Motion sought a determination that the parties did not

have a valid agreement to arbitrate, and the arbitrator did not have authority to preside over their dispute, because the Scheme Offering Documents were used solely to perpetrate and perpetuate a Ponzi scheme and were thus void *ab initio* and unenforceable. On May 3, 2013, the arbitrator denied the Declaratory Judgment Motion and ruled the dispute was properly in arbitration.

The defendants also filed a summary judgment motion in the arbitration proceeding (the "**Probate Motion**"), which argued that the Receiver's claims were barred by Florida Statutes Sections 733.702 and 733.710 (the "**Probate Statutes**") because they were not filed within two years of nonparty Herbert Schneiderman's ("**Mr. Schneiderman**") death. *See* Doc. 62, Ex. B. In opposition to the Probate Motion, the Receiver explained the straightforward legal rule that, under governing Florida law, claims that arise <u>after</u> a decedent's death are <u>not</u> subject to the Probate Statutes, and the Receiver's claims here arose after Mr. Schneiderman's death when the defendants received the single fraudulent transfer underlying this case from Victory. *See id.*, Ex. C. Nevertheless, relying on unsubstantiated allegations, the arbitrator erroneously granted the Probate Motion and dismissed the Receiver's claims (the "**Award**"). *See id.,* Ex. A. The Receiver filed a motion for reconsideration, but the arbitrator denied the motion. *See id.*, Exs. D & E.

On August 1, 2013, the Receiver filed a motion to vacate the Award (Doc. 61), and the defendants filed an opposition (Doc. 68). On January 10, 2014, the

Magistrate Judge recommended denial of the Receiver's motion to vacate. *See* Doc. 70. The Receiver objected to the recommendation (Doc. 71), and the defendants responded to the Receiver's objection (Doc. 72). On February 21, 2014, the District Court adopted the Report and Recommendation in full. Doc. 73. On March 19, 2014, the Receiver filed a timely notice of appeal of both the District Court's order compelling arbitration (Doc. 47) and its order refusing to vacate the arbitral award (Doc. 73). *See* Doc. 74.

Factual Background

Although neither the arbitrator nor the District Court ever reached the issue here, in other of the Receiver's clawback cases, the District Court held that, from at least 2000 through 2009, Nadel operated a "massive Ponzi scheme" through each Hedge Fund. *See Wiand v. Lee*, 2012 WL 6923664 (M.D. Fla. 2012), *adopted* 2013 WL 247361 (M.D. Fla. 2013).[3] Victory was created in 2001 and consequently operated as a Ponzi scheme from its inception. *Id.* at *2 n.5, 6. As part of that scheme, Nadel caused the Hedge Funds to make fraudulent transfers

[3] *See also Wiand v. Morgan*, 2012 WL 831538 (M.D. Fla. 2012), *adopted* 2013 WL 247072 (M.D. Fla. 2013); *Wiand v. Cloud*, 2013 WL 247004 (M.D. Fla. 2013) (combined R&R and Order); *Wiand v. Dancing $, LLC*, 2013 WL 246731 (M.D. Fla. 2013) (combined R&R and Order); *Wiand v. Mason*, 2012 WL 7071455 (M.D. Fla. 2012), *adopted* 2013 WL 542857 (M.D. Fla. 2013); *Wiand v. Meeker*, 2012 WL 6930504 (M.D. Fla. 2012), *adopted* 2013 WL 298335 (M.D. Fla. 2013); *Wiand v. Rowe*, Case No. 8:10-cv-245-T-17MAP (M.D. Fla.) (Doc. 106) (settled before R&R adopted).

relating to purported investments "with the actual intent to hinder, delay, or defraud [any creditor] as required by Fla. Stat[s]. § 726.105(1)(a)." *Id.* at *19.

On January 21, 2009, the District Court appointed the Receiver in the SEC Action and charged him with recovering those fraudulent transfers for the benefit of the Hedge Funds and their creditors, including defrauded investors who collectively lost approximately $168 million in the scheme. *See* SEC Action Doc. 8. Pursuant to this mandate, the Receiver identified "winning" investors like Mr. Schneiderman's estate (*i.e.*, the defendants), or "**profiteers**" – those that received more money from the scheme than they "invested" in it – and demanded they return the difference between what was received and what was "invested" – *i.e.*, their "**false profits**." Numerous profiteers settled with the Receiver pre-suit and returned the vast majority of their false profits. The Receiver then sued in the District Court profiteers who refused to settle, like the defendants (which totaled approximately 150 cases). The money the Receiver recovered through the settlements (and from other sources) is being distributed *pro rata* to the hundreds of investors who lost money in the scheme through a claims process established in the SEC Action. SEC Action Docs. 675, 776. To date, as a result of the Receiver's efforts, those losing investors have recovered approximately 44.37% of their losses through the claims process, but they almost certainly will never be made whole. SEC Action Docs 1113, 1114. In contrast, the defendants received a

windfall because the arbitrator allowed them to keep false profits, and the District Court refused to vacate the arbitrator's Award.

Specifically, in 2003, Mr. Schneiderman "invested" $100,000 in Victory, but he died in October 2007 before receiving any money from the scheme. *See* Doc. 62, Ex. B at 2, 4. After his death, the defendants requested a full redemption of his purported investment, and on July 16, 2008, the defendants received a transfer of $263,660.48. *Id.* at 4. Thus, the defendants received from the Hedge Funds **$163,660.48** more than Mr. Schneiderman "invested." *Id.* That amount represents their false profits, and it is the amount the Receiver sought to "clawback" in this matter. *Id.* Because Nadel operated Victory (and the other Hedge Funds) as a Ponzi scheme, that money did not represent actual investment gains, and it was not transferred to the defendants under the terms of any purported agreement; rather, it was stolen from other investors in the Hedge Funds and fraudulently transferred to the defendants to perpetuate the scheme. *See In re Slatkin*, 525 F.3d 805, 815 (9th Cir. 2008) (source of transfers paid to Ponzi scheme investor "was a theft from the other investors").

Unfortunately for Nadel, he could no longer raise sufficient money from "investors" to perpetuate his scheme, and only six months later it imploded and Nadel fled. He subsequently surrendered to federal authorities, was sentenced, and died in prison.

Standard of Review

The standard of review for the District Court's order compelling arbitration is *de novo*. *See Employers Ins. Of Wausau v. Bright Metal Specialties, Inc.*, 251 F.3d 1316, 1321 (11th Cir. 2001). The standard of review for the District Court's order refusing to vacate the Award is clear error with respect to factual findings and *de novo* with respect to legal conclusions. *See Gianelli Money Purchase Plan & Trust v. ADM Investor Servs.*, 146 F.3d 1309, 1311 (11th Cir. 1998).

SUMMARY OF THE ARGUMENT

As previously noted, the District Court held in every related cases which reached the pertinent phase that Nadel operated "a massive [P]onzi scheme" through the Hedge Funds, and as part of that scheme, Nadel made transfers "with the actual intent to hinder, delay, or defraud [any creditor] as required by Fla. Stat[s]. § 726.105(1)(a)." *See Lee*, 2012 WL 6923664 at *1. Undoubtedly, the District Court would have reached the same conclusion here, but it never had the opportunity because it compelled arbitration. In doing so, it relied on arbitration language in the purported security (or investment contract) at the very heart of the Ponzi scheme – *i.e.*, the purported investment contracts disseminated to bait investors into the scheme. The District Court erred in compelling arbitration for at least four independent reasons.

First, an inherent conflict exists between arbitration of clawback claims and the Receivership Statutes, and that conflict demonstrates that, like bankruptcy and similar statutory resolution mechanisms, Congress intended receivers and supervising courts to adjudicate clawback and all other claims to receivership property in a single forum: the court presiding over the receivership.

Second, even assuming *arguendo* a receiver could be compelled to arbitrate clawback claims, here the arbitration language was in Scheme Offering Documents that never came into existence as contracts because (1) there was no mutual assent between the parties under governing Florida law, (2) the managers of Victory (and of the other Hedge Funds) did not have the authority to bind Victory (or the other Hedge Funds) to the Scheme Offering Documents, and (3) the creation of Victory (and the other Hedge Funds) and the Scheme Offering Documents was *ultra vires*. Put simply, the District Court erroneously compelled arbitration based on purported contracts it later held in related cases were part of a massive Ponzi scheme.

Third, courts regularly treat purported contracts underlying Ponzi schemes as sham documents because they recognize it makes no sense to give force to illegal instruments used by criminals. Any reading of the Federal Arbitration Act (the "**FAA**") and state contract law to give force to such documents merely perpetuates the criminals' actions.

Fourth, even if the Scheme Offering Documents were contracts, the Receiver sued on behalf of each and every Hedge Fund because investors received money that was pooled and commingled across all Hedge Funds. Mr. Schneiderman, however, undisputedly had a purported contract only with Victory, and the defendants did not have a contract with any Hedge Fund. Under such circumstances, at minimum, the remainder of the Hedge Funds should not have been compelled to arbitrate their claims against the defendants.

Finally, even if the District Court did not err by compelling arbitration, the arbitrator improperly "dispens[ed] his own brand of industrial justice" (*Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 671-72 (2010)) and exceeded or "so imperfectly executed [his powers] that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C.A. § 10(a)(4). The arbitrator did so by granting the Probate Motion based on unsupported assertions which the arbitrator treated as "facts" and even though the Probate Statutes do not apply to claims that arise after a decedent's death, and the defendants did not receive the pertinent fraudulent transfer until after Mr. Schneiderman's death. As such, the District Court should have vacated the Award.

ARGUMENT

I. THE DISTRICT COURT ERRED BY COMPELLING ARBITRATION BECAUSE ARBITRATION OF THIS CASE WAS CONTRARY TO A CONGRESSIONAL COMMAND

Enforcement of arbitration clauses under the FAA is overridden by a contrary congressional command. *McMahon,* 482 U.S. at 226. This congressional command is "deducible . . . from an inherent conflict between arbitration and the statute's underlying purposes." *Id.* at 227; *Mitsubishi Motors,* 473 U.S. at 627-28; *Will-Drill Resources, Inc. v. Samson Resources Co.*, 352 F.3d 211, 214 (5th Cir. 2003) ("First, the court must determine whether the parties agreed to arbitrate the dispute. Once the court finds that the parties agreed to arbitrate, it must consider whether any federal statute or policy renders the claims nonarbitrable."). Here, the congressional command that should have foreclosed arbitration was deducible from the "inherent conflict" between the Receivership Statutes and the FAA.

In analyzing whether arbitration inherently conflicts with the purpose underlying the Receivership Statutes, the Magistrate Judge focused on the Securities Act of 1933 and the Securities Exchange Act of 1934 (*see* Doc. 42 at 22), and the District Court excerpted and adopted the Magistrate Judge's reasoning (*see* Doc. 47 at 10-12). In relevant part, the Magistrate Judge characterized the Receiver's argument as "rest[ing] on the notion that a securities enforcement action is the difference-maker here. Namely, the SEC's goals in enforcing the provisions

of the Securities Act of 1933 and the Securities and Exchange Act of 1934, [the Receiver's] . . . role in that enforcement action, and the Court's role in supervising [the Receiver] . . . and overseeing the receivership estate all make arbitration inappropriate." Doc. 42 at 22. The Magistrate Judge concluded, "the Supreme Court has rejected this argument by holding that actions for violations under these acts can be arbitrated." *Id.* (citing *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *McMahon*, 482 U.S. at 220).

By adopting the Magistrate Judge's reasoning, the District Court erred because the Receiver's principal argument against arbitration relied on the Receivership Statutes – not federal securities laws. As discussed below, the Receivership Statutes display congressional intent to provide district courts overseeing receiverships with "complete jurisdiction and control" of matters involving receivership property, including claims to clawback Receivership entities' money like those in this case. Arbitration directly conflicts with that purpose because it divests courts of jurisdiction and control and transfers control to arbitrators.

A. This Case Was Governed By Section 754 Because It Involved A Dispute Over Receivership Property

The Receiver asserted claims against the defendants under FUFTA, and in the alternative, for unjust enrichment to clawback certain money transferred from the scheme to the defendants as purported investment gains. That money is

Receivership property, and thus this case fell under the parameters of Section 754, which, as discussed below, conferred on the District Court "complete jurisdiction and control" over that money.[4] *See Freeman v. Dean Witter Reynolds, Inc.*, 865 So. 2d 543, 551 (Fla. 2d DCA 2003) (clawback claims involve "actions that the corporation, which has been 'cleansed' through receivership, may bring directly against the principals or the recipients of fraudulent transfers of corporate funds to recover assets rightfully belonging to the corporation and taken prior to the receivership"); *In re Wiand R'ship Cases*, 2007 WL 963165, *7 (M.D. Fla. 2007) (same regarding unjust enrichment claims); *see also Knauer v. Jonathon Robert Fin. Group*, 348 F.3d 230, 231-36 (7th Cir. 2003). As recipients of fraudulent transfers, the defendants merely hold the transferred money in constructive trust for the Receiver, and he is entitled to seek its recovery for the benefit of the Receivership estate. *See Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 250-51 (2000); *F.T.C. v. Network Servs. Depot, Inc.*, 617 F.3d 1127, 1142 (9th Cir. 2010) ("Importantly, that a transferee was not 'the original wrongdoer' does not insulate him from liability for restitution.").

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[4] Receivers sometimes assert a different category of claims: "common law tort claims against third parties to recover damages in the name or shoes of the corporation for the fraud perpetrated by the corporation's insiders . . . ." *Freeman*, 865 So. 2d at 551. This second category of claims does not involve receivership property and thus is subject to greater limitations. *Id.* Courts have occasionally required receivers to arbitrate such damages claims – the Receiver did not assert any such claims here.

B. Arbitration Inherently Conflicted With The District Court's "Complete Jurisdiction And Control" Over Receivership Property Under The Receivership Statutes

The Receivership Statutes display Congress's command to provide district courts overseeing receiverships with "complete jurisdiction and control" of receivership property, whether already in a receiver's possession or in the hands of third parties like the defendants. Specifically, Section 754 authorizes federal district courts, through a receiver "in any civil proceeding involving property . . . situated in different districts," to assert "complete jurisdiction and control of all such property with the right to take possession thereof." 28 U.S.C. § 754. Similarly, Section 1692 authorizes service of process in any district in which filings pursuant to Section 754 are made. 28 U.S.C. § 1692; *see S.E.C. v. Bilzerian,* 378 F.3d 1100, 1103 (D.C. Cir. 2004); *S.E.C. v. Vision Comm. Inc.,* 74 F.3d 287, 290 (D.C. Cir. 1996); *Haile v. Henderson Nat'l. Bank,* 657 F.2d 816, 823-24 (6th Cir. 1981). Congress enacted Sections 754 and 1692 "to facilitate judicial efficiency by permitting courts to manage claims regarding receivership property in a single forum." *Quilling v. Grand Street Trust*, 2005 WL 1983879, *2 (W.D.N.C. 2005); *Terry v. June,* 2003 WL 22125300, *5 (W.D. Va. 2003) ("[S]ubstantial weight must be given to the congressional policy behind the authorization of nationwide service of process," which promotes judicial efficiency by consolidating claims over receivership property "in a single forum.").

Specifically, Sections 754 and 1692 "contemplate consolidated jurisdiction of ancillary cases within the [d]istrict [c]ourt in which the [r]eceivership is established." *See Wiand v. Schnall*, Case No. 8:06-cv-706-T-27MSS (M.D. Fla.), Apr. 12, 2007, Order at 6 (Doc. 49). The Receivership Statutes further the goals of receiverships by allowing receivers to "marshal assets wherever they may be located." *Id.* The powers conveyed by Congress to receivers and district courts in Sections 754 and 1692 are based on "the need to recognize one locale – the locale of the [r]eceivership – as the proper venue to pursue claims ancillary to the [r]eceivership." *Id.* at 7 (*citing Bilzerian*, 378 F.3d at 1107; *Haile,* 657 F.2d at 822 n.6; *Hodgson v. Gilmartin*, 2006 WL 2707397, *7 (E.D. Pa. 2006)). To effectuate the centralized resolution of disputes involving receivership property, receivership courts have ancillary subject matter jurisdiction over every suit initiated by a receiver to carry out the receiver's duties, irrespective of whether diversity, amount in controversy, or any other typical requirements for subject matter jurisdiction are satisfied. *See Haile*, 657 F.2d at 822.

Aside from conferring "jurisdiction" over receivership property, Section 754 also confers "control." 28 U.S.C. § 754 (emphasis added). "Control" means to "exercise dominating influence or authority over." Webster's II Dictionary (3d ed. 2005). Thus, in Section 754 Congress allowed the District Court to exercise authority over all Receivership property, including the Receivership property held

by the defendants. Arbitration interfered with that power as it divested the District Court of the ability to exercise its congressionally-conferred authority over that property and to adjudicate the Receiver's claims to it.

Inclusion of the term "control" in Section 754 distinguishes that statute from other statutes that vest "exclusive jurisdiction" in a federal court but have been held not to foreclose arbitration. *See, e.g.*, *McMahon*, 482 U.S. at 227-28. One of the "cannons of statutory construction" is that courts must "assume that Congress used the words in a statute as they are commonly and ordinarily understood" and "read the statute to give full effect to each of its provisions." *United States v. DBB, Inc.*, 180 F.3d 1277, 1281 (11th Cir. 1999). "[W]ords in statutes should not be discarded as 'meaningless' and 'surplusage' when Congress specifically and expressly included them . . . ." *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972). By relinquishing control of this matter to an arbitrator, the District Court ignored Congress's command in the plain language of Section 754.

As a result of these errors, the Receiver had to file arbitrations (including the one underlying this appeal) in three different states with two separate ADR organizations. The Receiver prevailed on summary judgment in one such arbitration, and after a final hearing in another. Aside from this matter, the remainder of the arbitrations settled, but the Receiver nevertheless was required to pay tens of thousands of dollars from the Receivership estate to various arbitrators.

Forcing the Receiver to arbitrate directly conflicted with Congress's command to consolidate in the District Court all disputes involving Receivership property and the efficiencies of that centralized process. And this occurred because of arbitration language included by Nadel in the Scheme Offering Documents at the heart of his Ponzi scheme. In light of the unique situation here, including the District Court's nationwide jurisdiction, broad powers to adjudicate all issues affecting Receivership property, and expertise in receivership law and efficient management of these cases, arbitration was far more costly and inefficient then proceeding in the District Court.

Further, adjudication of the Receiver's claims by arbitrators resulted in inconsistent decisions affecting Receivership property because the District Court determined Nadel operated a "massive Ponzi scheme" through the Hedge Funds and granted summary judgment for the Receiver to recover false profits from the clawback defendants that did not compel arbitration (*see supra* fn. 4), but the arbitrator in this matter allowed the defendants to retain those scheme proceeds. Such disparate outcomes are precisely what Congress intended to prevent through Sections 754 and 1692. Indeed, such disparate treatment of receivership property is inconsistent with the entire purpose of a receivership. *See, e.g., Eller Indus., Inc. v. Indian Motorcycle Mfg., Inc.*, 929 F. Supp. 369, 372 (D. Col. 1995) (actions that confer on one creditor "a priority and preference over other creditors" are "contrary

to receivership law, which places receivership property under the [c]ourt's control for the equal benefit of all creditors"); *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"); *S.E.C. v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986) (same); *U.S. Commodity Futures Trading Comm'n v. Lake Shore Asset Mgmt. Ltd.*, 2010 WL 960362, *6 (N.D. Ill. 2010) (same).

C. Legislative History Also Reflects Congress's Command To Foreclose Arbitration Under The Circumstances Here

The legislative history of the Receivership Statutes shows that foreclosing arbitration of clawback claims is consistent with Congressional intent. Section 754 was enacted in 1948, but it re-codified an amended version of 28 U.S.C. § 117 ("**Section 117**"), which was enacted in 1911. *See* 28 U.S.C. § 754, Editor's and Revisor's Notes. Before 1911, a federal receiver could only reach property located within the district of the appointing court. *Link v. Powell*, 57 F.2d 591, 593 (W.D.S.C. 1932). This limitation hampered resolution of failed multi-district enterprises like railroads. *Id.* To increase receiverships' effectiveness, in 1911 Congress expanded the reach of federal receivers to encompass property located in all judicial districts within the appointing court's circuit. *See* Mar. 3, 1911, c. 231, § 56, 36 Stat. 1102. Quoting legislative history, *Link* explained that Section 117 – Section 754's predecessor – "applies to a case where a receiver is to be appointed

by a district judge covering property that runs across an entire circuit and includes a great number of districts, and it provides that the action of the district judge sitting in one circumscribed district shall be conclusive in the appointment of a receiver . . . ." 57 F.2d at 593. The court observed that "[n]o law is more firmly settled than that the court having jurisdiction, both of the receivers and of the subject matter, has exclusive power to administer the entire estate and property." *Id.* at 594.

In re-codifying Section 117 as Section 754, Congress further expanded the reach of receivers and receivership courts. "The revised section permits the receiver appointed by any district court to control all property of the defendant in whatever district the property is situated." 28 U.S.C. § 754, Editor's and Revisor's Notes. In first enacting Section 117 and later Section 754, Congress demonstrated a clear and deliberate desire to equip district courts and receivers with the power and jurisdiction to resolve in a single forum all matters relating to receivership property. Compelling arbitration of clawback claims would require multiple proceedings in different venues, unnecessarily deplete receivership assets, and directly conflict with Congress's demonstrated intent to allow receivership courts to resolve all such disputes (and that is precisely what happened here).

D. Arbitration Has Been Found To Inherently Conflict With Other Resolution Authority Statutes

Arbitration has been found to "inherently conflict" with the purposes of at least two other statutory schemes that, like receiverships, provide a centralized and efficient forum for addressing financial failures and claims relating to property covered by the statutes.

First, courts have held that arbitration of certain bankruptcy issues that are similar to the issues in this case is foreclosed because it inherently conflicts with bankruptcy statutes. "Congress intended to centralize disputes about a debtor's assets and legal obligations in the bankruptcy courts," and "[a]rbitration is inconsistent with centralized decision-making because permitting an arbitrator to decide a core issue would make debtor-creditor rights 'contingent upon an arbitrator's ruling' rather than the ruling of the bankruptcy judge assigned to hear the debtor's case." *In re White Mountain Mining Co., LLC.*, 403 F.3d 164, 169 (4th Cir. 2005); *see In re Brown*, 354 B.R. 591, 602-03 (Bankr. D.R.I. 2006) ("[W]here a conflict exists between the Bankruptcy Code and the FAA, a bankruptcy court retains discretion to decide whether and when to compel arbitration if the at-issue proceeding is core . . . ."). As one court explained,

> [t]he enforcement of the arbitration agreement as to the present matters would force [the trustee] to litigate these matters in a distant forum and under unfamiliar rules, at appreciable expense to the estate and with considerable delay. If arbitration clauses were regularly enforced as to such routine bankruptcy matters, these clauses would

> soon multiply in ordinary consumer credit agreements, and trustees and debtors would consequently be forced to adjudicate routine bankruptcy matters in diverse fora in every case, with (for example) each objection to a claim being arbitrated in a different forum. This in turn would undermine a system that was designed precisely to avoid such dissipation of the parties' energies and the estate's resources.

In re Payton Const. Corp., 399 B.R. 352, 364 (Bankr. D. Mass. 2009); *see Ford Motor Co. v. Roberson*, 2010 WL 4286077, *3 (D. Md. 2010) (upholding bankruptcy court's refusal to compel arbitration).

Importantly, fraudulent transfer claims, like those brought by the Receiver here, are considered core issues under the bankruptcy laws and thus held to be not-arbitrable in the above cited cases. *See, e.g.*, 28 U.S.C. § 157(b)(2)(H) (fraudulent transfer claims are "core proceedings" in bankruptcy); *In re Gandy*, 299 F.3d 489, 496-97 (5th Cir. 2002) (same). Further, broadly speaking, "[t]he goal in both securities-fraud receiverships and liquidation bankruptcy is identical – the fair distribution of the liquidated assets." *S.E.C. v. Wealth Mgmt. LLC*, 628 F.3d 323, 334 (7th Cir. 2010). In light of this and other similarities between bankruptcies and receiverships (*see S.E.C. v. First Sec. Co. of Chicago*, 507 F.2d 417, 420 (7th Cir. 1974) (upholding application of bankruptcy law to equity receivership); *S.E.C. v. Investors Sec. Leasing Corp.*, 476 F. Supp. 837, 842 (W.D. Pa. 1979) (same); *In re Franklin Mortg. & Inv. Co., Inc.*, 144 B.R. 194, 194 (Bankr. D.D.C. 1992) ("The Bankruptcy Code does not authorize receivers, but the case is analogous to a receivership action.")), the concerns with arbitration expressed in *Payton*

Construction and other bankruptcy cases are equally relevant to equity receiverships.

Second, the Federal Credit Union Act ("**FCUA**") is similar to receiverships and bankruptcies because it is "designed to protect the interests of creditors of defunct federal credit unions." *National Credit Union Admin. Board v. Lormet Comm. Fed. Credit Union*, 2010 WL 4806794, *2 (N.D. Ohio 2010). Claims within the scope of the FCUA are not arbitrable because of an inherent conflict with arbitration. *Id.* at 4.

> The Court finds an inherent conflict in this statutory scheme which operates to benefit all creditors, with the FAA which would essentially serve to place the rights of creditors who have agreements containing arbitration provisions on different footing than those unable to rely on arbitration provisions. In addition, requiring plaintiff to defend creditor claims in arbitration would defeat a primary purpose of the statute, *i.e.,* centralizing the claims process and preserving the limited assets of the defunct credit union.

Id. Like the FCUA, arbitration of clawback claims conflicts with the Receivership Statutes because it undermines the centralized resolution of disputes involving receivership property and removes some of that property from the receivership court's complete control.

E. The District Court's Inherent Equitable Power Is Consistent With A Congressional Command To Foreclose Arbitration

Unlike for bankruptcy and credit unions, however, Congress did not need to create a complex statutory scheme because receivership courts already have broad

equitable powers to effectuate Congress's grant of "complete jurisdiction and control" over disputes involving Receivership property. *S.E.C. v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992) (courts have "broad powers and wide discretion to determine relief in an equity receivership"); *see* S.*E.C. v. Vescor Capital Corp.*, 599 F.3d 1189, 1194 (10th Cir. 2010); *S.E.C. v. Safety Fin. Serv., Inc.,* 674 F.2d 368, 372-73 (5th Cir. 1982). "The court may properly draw to itself all disputes as to other rights pertaining to such property because 'every court has inherent equitable power to prevent its own process from working injustice to anyone.'" *Consolidated Rail Corp. v. Fore River Ry. Co.*, 861 F.2d 322, 327 (1st Cir. 1988) (*quoting* R. Clark, *Law & Practice of Receivers* § 280(a), at 446 (1959)). As the Tenth Circuit recently explained,

> [t]he basis for broad deference to the district court's supervisory role in equity receiverships arises out of the fact that most receiverships involve multiple parties and complex transactions, and the fact that a primary purpose of equity receiverships is to promote orderly and efficient administration of the estate by the district court for the benefit of the creditors.

Broadbent v. Advantage Software, Inc., 2011 WL 754838, *4 (10th Cir. 2011) (quotations and citations omitted); *see Hardy*, 803 F.2d at 1037 ("[R]easonable administrative procedures, crafted to deal with the complex circumstances of each case, will be upheld."). These broad powers are consistent with a Congressional command foreclosing arbitration.

Indeed, included among a receivership court's pertinent powers is "discretion to summarily reject formalistic arguments that would otherwise be available in a traditional lawsuit." *Broadbent*, 2011 WL 754838 at *5. Relying on these powers to achieve equity, receivership courts have rejected otherwise valid legal arguments in disputes involving receivership property, including arguments based on contract law. *See id.* ("[I]t was proper for the district court to summarily reject appellants' . . . various contract law arguments in favor of treating appellants like all other similarly situated claimants."); *see also Holmberg v. Armbrecht,* 327 U.S. 392, 396 (1946) ("[S]tatutes of limitation are not controlling measures of equitable relief" because "[e]quity eschews mechanical rules; it depends on flexibility"); *United States v. Durham,* 86 F.3d 70, 73 (5th Cir. 1996) (although "tracing [of claimant's funds in receivership estate] would have been permissible under the circumstances," the district court "in exercising its discretionary authority in equity was not obliged to apply tracing"); *United States v. Vanguard Inv. Co.,* 6 F.3d 222, 227 (4th Cir. 1993) ("[A] district court in its discretionary supervision of an equitable receivership may deny remedies like rescission and restitution where the equities of the situation suggest such a denial would be appropriate.").

Similarly, among the powers a receivership court has to effectuate Congress's desire for centralized resolution of disputes involving receivership

property is the power to enjoin actions in other venues. *See S.E.C. v. Wencke*, 622 F.2d 1363, 1370 (9th Cir. 1980) ("The power of a receivership court to prevent the commencement, prosecution, continuation, or enforcement of such [competing] actions has been recognized specifically in the context of securities fraud cases."); *Becker v. Greene*, 2009 WL 2948463, *4 (M.D. La. 2009) ("The Receiver and the Receivership Court's power to protect and marshal assets would be severely diminished if every court in the nation, state or federal, could make its own determination of what constitutes an asset of the 'Receivership Estate.'"); *S.E.C. v. Credit Bancorp, Ltd.*, 93 F. Supp. 2d 475, 476-77 (S.D.N.Y. 2000) ("[W]here a court has appointed a receiver and obtained jurisdiction over the receivership estate, as here, the power to stay competing actions falls within the court's inherent power to prevent interference with the administration of that estate.").

As *Eller Industries*, 929 F. Supp. at 371-72, explained, a receivership court has "exclusive jurisdiction over the assets and administration of the [r]eceivership":

> Federal Courts have the power, if necessary, to take control over an entity and impose a receivership free from interference in other court proceedings. . . . In the exercise of its jurisdiction over the debtor's property, the court has power to issue injunctions and all other writs necessary to protect the estate from interference and to ensure its orderly administration.

Id. (citation omitted). That power is necessary because a receivership's objective is to "prevent fraud and material injury to the assets of [the debtor] and to preserve

them for all parties in interest." *Id.* at 373; *see Oppenheimer v. San Antonio Land & Irrigation Co.*, 246 F. 934, 935 (5th Cir. 1917) (district court with "complete jurisdiction and control" over receivership property "was not in error in restraining proceedings in another court involving the same subject-matter"); *Chicago Title & Trust Co. v. Fox Theatres Corp.*, 69 F.2d 60, 61 (2d Cir. 1934) ("Receivership court has jurisdiction to decide all questions of preservation, collection, and distribution of assets."). All of this is consistent with a Congressional command to foreclose arbitration of disputes involving receivership properly like the clawback claims asserted in this case.

Significantly, the FAA explicitly contemplates foreclosure of arbitration on equitable grounds. *See* 9 U.S.C. § 2 (arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"). And here the equities weighed heavily against arbitration because "in a case involving a Ponzi scheme, the interests of the [r]eceiver are very broad and include not only protection of the receivership *res*, but also protection of defrauded investors and considerations of judicial economy." *Vescor Capital*, 599 F.3d at 1194. In this matter, arbitration did not conserve the Receivership *res*, protect defrauded investors, enhance judicial economy, or accomplish anything else that favors the receivership process. *See id.* In equity receiverships, "equality is equity," and through arbitration, the defendants obtained

unequal treatment of the Receivership property they possess because the arbitrator allowed them to keep their scheme proceeds. *Elliott*, 953 F.2d at 1570.

II. THE DISTRICT COURT ERRED BY COMPELLING ARBITRATION BECAUSE NO CONTRACT WITH AN ARBITRATION CLAUSE EVER CAME INTO EXISTENCE

Even assuming *arguendo* arbitration was not precluded by a Congressional command, the District Court erred by compelling arbitration because no contract with an arbitration clause ever came into existence. Arbitration "is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002); *Granite Rock Co. v. Int'l Broth. of Teamsters*, 130 S. Ct. 2847, 2859 (2010) (Supreme Court has "never held" that federal policy favoring arbitration "overrides the principle that a court may submit to arbitration only those disputes . . . that the parties have agreed to submit" (quotations omitted)). Arbitrators derive their authority to resolve disputes exclusively from parties' agreements to arbitrate. *Gateway Coal Co. v. Mine Workers*, 414 U.S. 368, 374 (1974). When, as the Receiver did here, a party challenges "the very existence of any agreement, including the existence of an agreement to arbitrate[,] . . . there is no presumptively valid general contract which would trigger the district court's duty to compel arbitration pursuant to the [Federal Arbitration] Act." *Chastain v. Robinson-Humphrey Co., Inc.*, 957 F.2d 851, 854 (11th Cir. 1992).

"[A] court may order arbitration of a particular dispute only where the court is satisfied that the parties agreed to arbitrate *that dispute*." *Granite Rock Co.*, 130 S. Ct. at 2856.[5] "To satisfy itself that such agreement exists, the court must resolve any issue that calls into question the formation or applicability of the specific arbitration clause that a party seeks to have the court enforce." *Id.* Courts should apply ordinary rules that govern the formation of contracts when deciding whether parties agreed to arbitrate any matter. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995); *Global Tel Link Corp. v. Scott*, 652 F. Supp. 2d 1240, 1246 (M.D. Fla. 2009); *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1368 (11th Cir. 2005) (courts should apply contract law of particular state that governs formation of contracts).

The first step is for a court to decide whether a contract exists before deciding whether to impose a stay and order arbitration. *Chastain*, 957 F.2d at 854; *see also Buckeye Check Cashing, Inc. v. Cardegna,* 546 U.S. 440, 444, n.1 (2006) ("it is for courts to decide whether the alleged obligor ever signed the contract; whether the signor lacked authority to commit the alleged principal; and whether the signor lacked the mental capacity to assent" (citations omitted)). The party moving to compel arbitration must establish the existence of a binding

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[5] Under Section 3 of the FAA, the court must be "satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement. . . ." 9 U.S.C. § 3 (emphasis added).

agreement with an arbitration clause between the parties. *Schoendorf v. Toyota of Orlando,* 2009 WL 1075991, *7 (M.D. Fla. 2009). This determination is governed by state contract law. *Id.* Here, the defendants never satisfied this burden for several independent reasons, and the District Court erred by determining the Scheme Offering Documents reflect a contract that came into existence.

A. The Defendants Failed To Show Mutual Assent Between The Parties

The District Court erred in compelling arbitration because the defendants never satisfied their burden of showing mutual assent between the parties to the Scheme Offering Documents. Under Florida law, "a meeting of the minds of the parties on all essential elements is a prerequisite to the existence of an enforceable contract . . . ." *Barnes v. Diamond Aircraft Indus., Inc.*, 499 F. Supp. 2d 1311, 1316 (S.D. Fla. 2007). Offer and acceptance of contract terms must be evident, and mutual assent must be shown between the parties by a preponderance of the evidence. *Holloway v. Gutman*, 707 So. 2d 356, 357 (Fla. 5th DCA 1998); *St. Joe Corp. v. McIver*, 875 So. 2d 375, 381 (Fla. 2004). The requisite mutuality cannot exist when there is no common intention. *Kuharske v. Lake County Citrus Sales*, 44 So. 2d 641, 643 (Fla. 1949). In the absence of mutual assent, neither the contract nor any of its provisions come into existence. *State v. Family Bank of Hallandale,* 623 So. 2d 474, 479-80 (Fla. 1993).

First, the defendants never satisfied their burden of showing that Victory assented to the Scheme Offering Documents as there is no record evidence that anyone executed or approved them purportedly on behalf of Victory. *See Chastain*, 957 F.2d at 845-55 ("If a party has not signed an agreement containing arbitration language, such a party may not have agreed to submit grievances to arbitration at all."); *Wheat, First Secs., Inc. v. Green*, 993 F.2d 814, 817-19 (11th Cir. 1993); *see also Shearson, Lehman, Hutton, Inc. v. Lifshutz*, 595 So. 2d 996, 997 (Fla. 4th DCA 1992) (refusing to compel arbitration of claims in connection with brokerage accounts where appellant failed to submit any evidence that appellee had signed or assented to brokerage agreement containing arbitration provision). Indeed, as a matter of law, the defendants could not have satisfied this burden because the pertinent Scheme Offering Documents were never executed or approved by any purported representative of Victory, let alone an authorized representative. *See* Doc. 30 (unexecuted documents). The Magistrate Judge rejected this argument because "the FAA requires the arbitration provision to be 'written'; it does not require the agreement to be signed by either party" (Doc. 42 at 12), but that conclusion does not address mutual assent under Florida law. Without the requisite showing by the defendants of mutual asset, claims relating to transfers from Victory were not arbitrable.

Second, Mr. Schneiderman was the only person who signed the Scheme Offering Documents, but he died before receiving any transfers from the scheme. It is undisputed the defendants never executed any of the Scheme Offering Documents, and there was never a contract between the defendants and Victory (or any other Hedge Fund). *See* Doc. 62, Ex. B at 2-4. As nonparties to the purported contracts and arbitration provisions, there was no mutual assent between the defendants and Victory (or any other Hedge Fund) and the defendants never established they were entitled to step into Mr. Schneiderman's shoes.

Third, even without a signature or express approval, a party may assent to be bound through its acts or performance. *See, e.g., Turner v. U-Haul Co. of Fla. 905, LLC*, 2008 WL 709107, *4 (M.D. Fla. 2008). Here, the defendants also failed to show mutual assent through this alternative method. There is no record evidence that either Victory or the other Hedge Funds or their purported representatives, the Fund Managers, engaged in any act or performance that was consistent with any Scheme Offering Document. Although Mr. Schneiderman may have believed he was purchasing interests in legitimate investment funds, his investment money simply was being stolen as part of a Ponzi scheme. *Lee*, 2012 WL 6923664 at *1. Such conduct on the side of the Hedge Funds did not show 'assent' to the terms of the Scheme Offering Documents; rather, it demonstrated lack of any common intention or meeting of the minds.

B. The Defendants Failed To Show The Fund Managers Had Authority To Execute Scheme Offering Documents

The District Court erred by compelling arbitration because the defendants failed to show the Fund Managers had authority to execute Scheme Offering Documents on behalf of or otherwise bind Victory or any other Hedge Fund, and as such, the defendants never established that a contract with an arbitration clause came into existence. *See Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 111 (3d Cir. 2000) (courts decide whether signor lacked authority to commit alleged principal); *Sphere Drake Ins. Ltd. v. All Am. Life Ins. Co.*, 300 F. Supp. 2d 606, 629 (N.D. Ill. 2003) (same). Indeed, the defendants cannot show this because as a matter of law the Fund Managers lacked such authority. Without authority to bind Victory or any other Hedge Fund, the Receiver should not have been compelled to arbitrate any claim as a result of the Fund Managers' acts. *See Par-Knit Mills, Inc. v. Stockbridge Fabrics Co., Ltd.*, 636 F.2d 51, 55 (3d Cir. 1980) ("If the production manager did not have the actual or apparent authority to execute the contract, the corporation cannot be bound, no matter how clearly the document was labeled."); *Sandvik*, 220 F.3d at 111; *Sphere Drake*, 300 F. Supp. 2d at 629.

Any act by the Fund Managers to purportedly bind Victory or any other Hedge Fund to the Scheme Offering Documents, including to their arbitration clauses, cannot be imputed because the purported agents, the Fund Managers, were acting adversely to the interests of their purported principals, the Hedge Funds. An

agent may only act for the benefit of the principal. Restatement (Second) of Agency § 396(b); *Apollo Techs. Corp. v. Centrosphere Indus. Corp.*, 805 F. Supp. 1157, 1195 (D.N.J. 1992). An agent's authority to act is terminated when the agent ceases to act for the benefit of the principal and instead acts for its own benefit. *Apollo Techs.*, 805 F. Supp. at 1197. Consequently, the conduct of an agent cannot be imputed to, and therefore bind, a principal when the agent is acting entirely in its own interests and adversely to the interests of the principal. *See In re Phoenix Diversified Inv. Corp.*, 439 B.R. 231, 242 (S.D. Fla. 2010) (when "agent's misconduct is calculated to benefit the agent and harms the corporation, the agent has forsaken the corporation and acts only for himself"); *LanChile Airlines v. Conn. Gen. Life Ins. Co. of N. Am.*, 759 F. Supp. 811, 814 (S.D. Fla. 1991) (same); *see also Munroe v. Harriman*, 85 F.2d 493, 495 (2d Cir. 1936) ("The truth is that where an agent, though ostensibly acting in the business of the principal, is really committing a fraud, for his own benefit, he is acting outside of the scope of his agency, and it would therefore be most unjust to charge the principal with knowledge of it."); *Freeman*, 865 So. 2d at 550 ("sins" of agent do not "transfer to the corporation").

Here, the defendants relied entirely on the premise that, as an agent of Victory, its Fund Manager, Scoop Capital, LLC ("**Scoop Capital**"), had the authority to execute on behalf of or otherwise bind Victory to the Scheme Offering

Documents. Scoop Capital's pertinent conduct, however, simply created and perpetuated the scheme, which was in its (and the other Fund Managers') interest because it received grossly inflated management and performance fees from Victory based on the bogus performance reported to investors. *See Lee,* 2012 WL 6923664 at *7. By the time the District Court compelled arbitration of this matter, Nadel was already serving a 14-year term of imprisonment after pleading guilty to defrauding investors through the Funds Managers and the Hedge Funds. *See* Doc. 26, Exs. 2, 3; *McCarthy v. United States*, 394 U.S. 459, 466 (1969) ("[A] guilty plea is an admission of all the elements of a formal criminal charge"); *United States v. Kimble*, 139 Fed. Appx. 221, 225 (11th Cir. 2005) ("[T]he time-honored rubric that a plea of guilty is a judicial admission of the truth of the factual allegations of the indictment . . . ."); *In re Rothstein Rosenfeldt Adler,* 2010 WL 5173796, *5 (S.D. Fla. 2010) (Ponzi scheme operator "admitted to each and every allegation"); *In re McCarn's Allstate Fin., Inc.*, 326 B.R. 843, 851 (Bankr. M.D. Fla. 2005) (Ponzi scheme operator "admitted and pleaded guilty to all the allegations in the Information"). Scoop Capital's conduct thus harmed Victory, and as a matter of law, Scoop Capital could not have been acting as Victory's agent. *See Scholes v. Lehman,* 56 F.3d 750, 754 (7th Cir. 1995) ("The corporations, [the Ponzi operator's] robotic tools, were nevertheless in the eyes of the law separate legal entities with rights and duties."); *Grand St. Trust*, 2005 WL

1983879 at *5 (receivership entity "was damaged due to the loss of [transferred] funds"); *Marwil v. Farah*, 2003 WL 23095657, *7 (S.D. Ind. 2003) (receivership entity "itself has suffered an injury"). Since Scoop Capital did not have authority to bind Victory to the Scheme Offering Documents, those documents do not reflect any contract between the defendants and Victory or its Receiver.

1. The District Court Incorrectly Concluded The Fund Managers' Authority To Bind The Hedge Funds Implicates Contract Validity Rather Than Contract Existence

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), the Supreme Court considered a challenge to the validity of a contract with an arbitration clause and concluded that challenge should be decided by an arbitrator. More recently, in *Buckeye,* 546 U.S. at 440, the Supreme Court affirmed *Prima Paint*. Importantly, *Buckeye* distinguished challenges to a contract's validity from challenges to its existence. The Court noted:

> [t]he issue of the contract's validity is different from the issue whether any agreement between the alleged obligor and obligee was ever concluded. Our opinion today addresses only the former, and does not speak to the issue decided in the cases cited by respondents (and by the Florida Supreme Court), which hold that it is for courts to decide whether the alleged obligor ever signed the contract; whether the signor lacked authority to commit the alleged principal; and whether the signor lacked the mental capacity to assent.

Id. at 449 n.1 (citations omitted); *see Granite Rock*, 130 S. Ct. at 2855-58 (court, not arbitrator, decides challenge to formation of purported contract with arbitration clause); *see also Dedon GmbH v. Janus et Cie*, 2011 WL 31868, *2 (2d Cir. 2011)

("*Granite Rock* reconfirms . . . that where a party challenges the very existence of the contract containing an arbitration clause, a court cannot compel arbitration without first resolving the issue of the contracts existence."); *Composition Roofers Local 4 Pension Fund v. Best Roofing of N.J., Inc.*, 2009 WL 5033945, *2 (D.N.J. 2009) ("[T]he qualification provided by the footnote [in *Buckeye*] is crucial: disputes over 'whether the alleged obligor ever signed the contract . . . [or] whether the signor lacked authority to commit the alleged principal' are *not* disputes over contract validity, within the meaning of *Buckeye.* Rather, they are disputes over whether any agreement was ever concluded, which is an issue for the courts to decide, not the arbitrator.").

Before *Buckeye* and *Granite Rock*, but consistent with them, the Eleventh Circuit held that when a party challenges "the very existence of any agreement, . . . there is no presumptively valid general contract which would trigger the district court's duty to compel arbitration pursuant to the [Federal Arbitration] Act." *Chastain*, 957 F.2d at 854. The Court observed that "*Prima Paint* has never been extended to require arbitrators to adjudicate a party's contention, supported by substantial evidence, that a conjavtract never existed at all." *Id.* at 855.[6] That was precisely the Receiver's contention here. As such, a party against whom

[6] *See also Krutchik v. Chase Bank USA, N.A.*, 531 F. Supp. 2d 1359, 1363 (S.D. Fla. 2008); *Sanford v. MemberWorks, Inc.*, 483 F.3d 956, 962 (9th Cir. 2007); *Gregory v. Interstate/Johnson Lane Corp.*, 1999 WL 674765, *9 (4th Cir. 1999); *Will-Drill Resources, Inc.*, 352 F.3d at 219.

arbitration is sought, like the Receiver, may challenge the authority of a purported agent to enter into a contract as a whole, rather than the particular arbitration provision. *See Bess v. Check Express*, 294 F.3d 1298, 1306 (11th Cir. 2002) (recognizing that *Sandvik* and *Sphere Drake* all involve "questions of assent to the general contract").

Here, in relevant part, the Receiver argued the defendants could not show the existence of a contract because Scoop Capital was acting adversely to the interests of its purported principal, Victory, and thus could not bind Victory to the Scheme Offering Documents. The District Court, however, concluded the Receiver's argument impermissibly challenged the "validity" of the Scheme Offering Documents as a whole. *See* Doc. 47 at 15. Further, the District Court concluded, "[a]s the Receiver's challenges go to the legal formation of the agreements, they are for the arbitrators to consider." *Id.* Those conclusions are wrong because the Receiver's argument was plainly one of existence because "[i]f [an agent's] signature is not binding, there is no arbitration clause." *Sandvik*, 220 F.3d at 108; *see also Composition Roofers*, 2009 WL 5033945 at *2 (whether signor lacked authority to commit alleged principal is *not* a dispute over contract validity). Also, courts – not arbitrators – must decide challenges to the formation of the contract, like the Receiver's challenge here. *Granite Rock Co.*, 130 S. Ct. at 2855-58. Simply put, the District Court failed to appreciate the significance of the

footnote in *Buckeye*, and incorrectly categorized the Receiver's arguments as a challenge to validity of the purported contact.[7] *See Composition Roofers*, 2009 WL 5033945 at *2.

C. The District Court Erred By Determining The Scheme Offering Documents Came Into Existence Because Their Creation And Execution Were *Ultra Vires*

An entity can only perform acts authorized by law or its charter. *Head & Amory v. Providence Ins. Co.*, 6 U.S. 127, 139 (1804); *see Baumann v. Long Cove Club Owners Ass'n, Inc.*, 380 S.C. 131, 138 (S.C. Ct. App. 2008). Any conduct by an entity, or on its behalf, must fall within the authority conferred upon the entity. *See Owens Corning v. Nat'l Union Fire Ins. Co. of Pitt., PA*, 257 F.3d 484, 495 (6th Cir. 2001). Thus, in conducting affairs relating to the Hedge Funds, the Fund Managers must have acted "consistent with public policy" and controlling Florida law. That did not happen. Instead, the Fund Managers formed unlawful limited partnerships (*i.e.*, Hedge Funds Valhalla, Victory, Victory IRA, and Scoop) and limited liability companies (*i.e.*, Hedge Funds Viking and Viking IRA) and purportedly executed the Scheme Offering Documents and engaged in other acts in furtherance of a Ponzi scheme. The creation of the Hedge Funds and all other acts

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[7] By failing to properly recognize the Receiver challenged contract existence instead of contract validity, the District Court incorrectly applied the "'national policy' . . . favoring arbitration agreements." Doc. 47 at 7. That "policy" does <u>not</u> apply to challenges to the <u>existence</u> of a contract with an arbitration provision. *Klay v. All Defs.*, 389 F.3d 1191, 1200 (11th Cir. 2004); *Granite Rock Co.*, 130 S. Ct. at 2859.

of the Fund Managers purportedly on behalf of the Hedge Funds were unlawful and thus beyond the scope of their power.

An act by an entity that is "beyond the scope of power allowed or granted by a corporate charter or by law" is *ultra vires*. *Black's Law Dictionary* 1559 (8th ed. 2004); *Liberty Counsel v. Fla. Bar Bd. Of Governors*, 12 So. 3d 183, 191 (Fla. 2009). A purported contract that is made *ultra vires* "is not voidable only, but wholly void, and of no legal effect." *California Nat'l Bank v. Kennedy*, 167 U.S. 362, 367 (1897) (citation omitted; emphasis added).

Here, Victory (and the other Hedge Funds) and the Scheme Offering Documents were used exclusively to perpetrate and perpetuate a Ponzi scheme. As mentioned above, the District Court ultimately concluded in related clawback cases that Arthur Nadel operated a "massive Ponzi scheme" through the Hedge Funds. *Lee*, 2012 WL 6923664 at *1. While the District Court had not yet reached that conclusion when it compelled arbitration in this case, the Receiver nevertheless provided the District Court with substantial evidence of the Ponzi scheme. *See* Doc. 26. Indeed, Nadel was serving 14 years' imprisonment when the District Court compelled arbitration. Specifically, on April 28, 2009, he was indicted on six counts of securities fraud, one count of mail fraud, and eight counts of wire fraud in connection with the scheme. *See United States v. Arthur G. Nadel*, Case No. 09-cr-433 (S.D.N.Y.); Doc. 26, Ex. 3, (the "**Indictment**"). On February 24,

2010, he pled guilty (*see* Doc. 26, Ex. 2) and admitted at paragraph 8 of the Indictment that:

> From at least in or about 1999 through in or about January 2009, . . . [he] perpetrated a scheme to defraud the investors of the [Hedge] Funds by soliciting hundreds of millions of dollars of funds under false pretenses, failing to invest the money as promised, falsely claiming that his purchases and sales of securities resulted in high rates of returns, and misappropriating and converting investor funds for his own benefit and the benefit of others without the knowledge and authorization of investors.

Doc. 26, Ex. 3 ¶ 8. Nadel's guilty plea, standing alone, established the Hedge Funds were part of a fraudulent scheme. *See, e.g., Financial Federated Title and Trust, Inc. v. Kozyak*, 347 F.3d 880, 886 n.5 (11th Cir. 2003) ("The guilty pleas of [the defendants] undisputably establish that this Debtor's operations were nothing more than a massive fraud and Ponzi scheme. The guilty pleas of [the defendants] . . . eliminate the need for [the trustee] to prove the continuing fraud."); *In re McCarn's Allstate Fin.*, 326 B.R. at 851; *In re Saltkin*, 310 B.R. 740, 749 (C.D. Cal 2004); *Scholes*, 56 F.3d at 762; *In re Mark Benskin & Co., Inc.,* 161 B.R. 644, 648-49 (Bankr. W.D. Tenn. 1993); *Raiford v. Abney*, 695 F.2d 521, 523 (11th Cir. 1983); *In re Rodriguez,* 209 B.R. 424, 433 (S.D. Tex. 1997); *Terry v. Dowdell*, 2006 WL 2360933, *3 (W.D. Va. 2006).

For Victory (and the other Hedge Funds), relevant laws prohibited its use as part of an illegal Ponzi scheme.[8] Scoop Capital was supposed to create Victory to "seek capital appreciation through investing and active trading in securities . . . ." *See* Doc. 26, Ex. 1. at § 1.2. In reality, however, the asserted "purpose" was a sham. As admitted by Nadel, Victory and the other Hedge Funds were created and operated from their inception to perpetrate and perpetuate a massive Ponzi scheme. *See id.*, Ex. 2. As such, Victory and the other Hedge Funds' interactions with purported investors were to steal their money and thus were unlawful. Accordingly, Victory (and the other Hedge Funds') creation and operation and the use of the Scheme Offering Documents were *ultra vires*, and none of the Scheme Offering Documents reflected any contract.

D. The District Court Incorrectly Concluded That Defendants Satisfied Their Burden Of Showing The Scheme Offering Documents Reflected Contracts That Came Into Existence

By seeking to compel arbitration, the defendants bore the burden of proving the existence of an agreement to arbitrate. *Schoendorf,* 2009 WL 1075991 at *7. Although the burden remains with the party seeking to arbitrate, the party opposing arbitration must (1) unequivocally deny the agreement was made and (2) produce "some evidence" substantiating the denial. *Chastain,* 957 F.2d at 854 (citing *T&R*

[8] For example, under the Florida Limited Partnership Act, which in relevant part governed Victory, "[a] limited partnership may be organized under this act for any lawful purpose." Fla. Stat. § 620.1104(2).

Enters. v. Continental Grain Co., 613 F. 2d 1272, 1278 (5th Cir. 1980)). The Receiver did just that, but the District Court misapplied both burdens.

First, the District Court incorrectly found the defendants satisfied their burden of proving the existence of an agreement to arbitrate because, as explained in Section II.B.1. above, the District Court mischaracterized the Receiver's argument regarding the authority of Scoop Capital and the other Fund Managers to bind Victory and the other the Hedge Funds as one of validity rather than existence. *See* Doc. 47 at 13-16; 42 at 9-10. In doing so, the District relied on a passage in *Chastain*, which contrasted the facts in that case with those in most arbitrability disputes:

> Under normal circumstances, an arbitration provision within a contract admittedly signed by the contractual parties is sufficient to require the district court to send any controversies to arbitration. Under such circumstances, the parties have at least presumptively agreed to arbitrate any disputes, including those disputes about the validity of the contract in general. Because the making of the arbitration agreement itself is rarely in issue when the parties have signed a contract containing an arbitration provision, the district court usually must compel arbitration immediately after one of the contractual parties so requests.

957 F. 2d at 854. This case, like *Chastain*, presents one of those atypical instances where "the making of the arbitration agreement itself" was an issue because the Receiver asserted (with supporting evidence) the Fund Managers did not have authority to bind the Hedge Funds to the Scheme Offering Documents, so no contract with an arbitration provision between the defendants and the Hedge Funds

ever came into existence. The defendants produced physical copies of the Scheme Offering Documents, but their burden required more. The defendants were also required to show those documents came into existence as contracts, but they failed to do so.

Second, the District Court incorrectly found the Receiver failed to satisfy his burden of producing "some evidence" substantiating his denial that any contract with an arbitration provision between Victory and the defendants ever came into existence. *See* Doc. 47 at 14; Doc. 42 at 10. In truth, the Receiver submitted more than the requisite "some evidence," by filing copies of Nadel's Indictment and his plea agreement and by referencing specific documents in the SEC Action. *See* Doc. 25 at 12-16; Doc. 26, Exs. 2, 3. The Receiver also discussed the preclusive effect of Nadel's guilty plea and how that plea operated as an admission of every allegation in the Indictment. *See* Doc. 25 at 15-16. Collectively, those items provided much more than just "some evidence" that the Scheme Offering Documents did not reflect any contracts that came into existence because the Receiver's proof established that Scoop Capital and the other Fund Managers purported to enter into them with investors on behalf of Victory and the other Hedge Funds solely so Nadel could perpetrate and perpetuate his Ponzi scheme. And, of course, the District Court ultimately concluded in related cases that indeed Nadel used the Fund Managers to operate a "massive Ponzi scheme" though the

Hedge Funds. *Lee*, 2012 WL 6923664 at *1. Consequently, like in *Chastain*, the "trigger of the court's power to compel arbitration . . . – the existence of a presumptively valid arbitration agreement contained within a contract signed by the parties – is entirely absent in this case." *Id.* (emphasis added). At a minimum then, the Receiver was entitled to a trial in the District Court on the issue of whether any contract with an arbitration agreement between Victory and the defendants ever came into existence (9 U.S.C. § 4), and thus the District Court erred by compelling arbitration.

III. AS A MATTER OF PUBLIC POLICY, THE SCHEME OFFERING DOCUMENTS ARE NOT CONTRACTS

Below, the Receiver also argued the Scheme Offering Documents were not contracts that came into existence because they were sham instruments at the heart of Arthur Nadel's Ponzi scheme. *See* Doc. 25 at 16-22. The District Court failed to consider these arguments, however, because it determined they were "attacks on the validity of an entire contract, as distinct from attacks aimed at the arbitration clause..." Doc. 47 at 15 (quotation omitted). According to the District Court, because "the Receiver's challenges [went] to the legal formation of the agreements, they [were] for the arbitrators to consider." *Id.* The District Court erred by deferring to arbitrators here because, in related cases, it ultimately concluded Nadel used the Scheme Offering Documents to perpetrate a "massive Ponzi scheme." *Lee*, 2012 WL 6923664 at *1. As explained below in Section

III.A., courts refuse to enforce such contracts, and as explained below in Section III.B., they are also illegal and void *ab initio* under Florida law. By compelling arbitration of this matter, the District Court improperly enforced a provision in a fraudulent security at the heart of a Ponzi scheme.

A. Courts Treat "Investment Contracts" Used In Ponzi Schemes As Sham Instruments, And There Is No Reason To Exempt Their Arbitration Provisions

As a matter of public policy, purported investment contracts underlying fraudulent schemes are treated as sham instruments, regardless of the culpability (or innocence) of the party seeking enforcement of a contractual provision. *See, e.g.*, *Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011) (rejecting "form over substance rule in fraudulent transfer actions involving Ponzi schemes" that "ignore[s] the realities of how Ponzi schemes operate"); *In re Randy*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995) (in Ponzi scheme cases "the interest of the public, rather than the equitable standing of individual parties, is of determining importance"). "In determining whether a contract is unenforceable because it is against public policy, the court may look beyond the terms of the contract itself to the underlying facts." *In re Indep. Clearing House Co.*, 77 B.R. 843, 858 (D. Utah 1987). The purported contract need not be facially unlawful or create an illegal investment vehicle; rather, it is sufficient that it is used in furtherance of an unlawful scheme. *See, e.g., Sender v. Simon*, 84 F.3d 1299, 1307 (10th Cir. 1996)

("Though the Debtor Partnerships were not illegal per se, it is beyond peradventure they were created and operated in furtherance of a fraudulent and illegal investment scheme.") *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 12 n.16 (S.D.N.Y. 2007) (rejecting argument that "intent at the outset" was legitimate trading because investment fund ultimately became "full blown Ponzi scheme").

The Scheme Offering Documents are exactly the type of purported investment contracts that courts treat as sham instruments and refuse to enforce on public policy grounds. Those documents were not used to raise money for a genuine or lawful endeavor.[9] Rather, Nadel admitted the scheme began at the inception of the first Hedge Fund in 1999 and continued until January 2009. As such, Mr. Schneiderman's execution of Scheme Offering Documents and his purported "investment" in Victory in 2003 were not part of a genuine or legitimate investment; they were merely part of Nadel's massive fraud. *See, e.g.*, *Donell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008) (noting an "investment" in fraudulent scheme is not a "true investment").

As *Randy* poignantly observed, enforcing sham instruments like the Scheme Offering Documents "would only help finish what [the wrongdoer] ... long ago started, which is, defrauding many innocent investors." 189 B.R. at 441. Indeed,

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[9] Although Victory was created as an actual corporate entity under Florida law, its use was always fraudulent. *See Lee*, 2012 WL 6923664 at *6 (holding scheme began no later than 2000), *2 n.5 (noting Victory was not formed until 2001).

enforcing any such agreements would only exacerbate the harm to creditors. *Id.*; *Warfield v. Carnie,* 2007 WL 1112591, *12-13 (N.D. Tex. 2007) (characterizing Ponzi scheme investment contract as "illegal" and refusing enforcement "because an illegal contract is void"); *Janvey v. Alguire et al.*, 2013 WL 2451738, *9 (N.D. Tex. 2013) ("In light of these decisions, especially *Warfield,* the Court sides with those courts that choose not to enforce investment contracts with a Ponzi scheme."); *VesCor Capital Corp. v. Valle Verde Ltd. P'ship,* 2009 WL 223532, *2 (D. Utah 2009) (holding rights that "arose under contracts presumed by law to be illegal" are "invalid," and their enforcement "would in essence permit [Ponzi] scheme to run one more round"); *Sender*, 84 F.3d at 1307-09 (10th Cir. 1996) ("[T]his court will not aid in the enforcement of an agreement that was fraudulently procured in furtherance of an illegal purpose."); *Independent Clearing House,* 77 B.R. at 858 ("Enforcement of a contract such as those involved here would therefore hurt the debtors' other creditors. . . ."). In short, the District Court erred by compelling arbitration based on language in purported contracts it later determined where used as part of a "massive Ponzi scheme." *Lee*, 2012 WL 6923664 at *1.

B. Florida Law Also Does Not Recognize The Scheme Offering Documents As Contracts

Under Florida law, "[a] contract which violates a provision of the constitution or a statute is void and illegal and will not be enforced in our courts."

Harris v. Gonzalez, 789 So. 2d 405, 409 (Fla. 4th DCA 2001); *see Wechsler v. Novak,* 26 So. 2d 884, 887 (Fla. 1946) ("The general right to contract is subject to the limitation that the agreement must not violate the Federal or State Constitutions or state statutes or ordinances of a city or town or some rule of the common law."). Specifically relevant here, any contract that violates Florida's securities laws "confers no enforceable rights on the contracting parties." *Edwards v. Trulis*, 212 So. 2d 893, 895 (Fla. 4th DCA 1968); *see Umbel v. Foodtrader.com, Inc.*, 820 So. 2d 372, 374 (Fla. 3d DCA 2002) ("the very facts recited in the complaint belie a conclusion that there was a legal purpose behind the partnership agreement…"). Importantly, such contracts are not voidable by an innocent party to the contract; they are unequivocally void *ab initio*. *See Edwards*, 212 So. 2d at 896. Indeed, "[t]he great weight of authority is that where a party comes into court seeking to enforce a contract which is against public policy or is prohibited by public law, the court will refuse to aid either party and will leave them where they have placed themselves…." *Id.* at 895-96 (citation omitted).

As the District Court ultimately determined in related cases, Victory and the other Hedge Funds were used as part of a massive and criminal fraudulent scheme, and in connection with that scheme, Nadel pled guilty to multiple federal securities

fraud counts.[10] As such, the Scheme Offering Documents – which were the very "securities" being offered and sold to fund and otherwise perpetrate the scheme – were not used for any genuine purpose. Rather, they were the vehicle used by Nadel to engage in knowingly and willfully criminally fraudulent activity to obtain money from investors and converting the investors' money to his own use. Doc. 26, Ex. 3. As a result and as the Florida Supreme Court has recognized, the Scheme Offering Documents, and all provisions contained in them – including the arbitration provisions – are void under Florida law and therefore not enforceable:

> We conclude that Florida public policy and contract law prohibit breathing life into a potentially illegal contract by enforcing the included arbitration clause of the void contract. Florida's law has long held that contracts which are determined to be against public policy and void should not be enforced. A contract which violates a provision of the constitution or a statute is void and illegal and will not be enforced in our courts.... In other words, there are no severable, or salvageable, parts of a contract found illegal and void under Florida law. Judge Sharp's observation in *Party Yards, Inc.,* that a contrary holding would lead to an absurd result is right on point. We do not believe federal arbitration law was ever intended to be used as a means of overruling state substantive law on the legality of contracts.

Cardegna v. Buckeye Check Cashing, Inc., 894 So. 2d 860, 864 (Fla. 2005) (citations and quotations omitted). Because the existence of a binding agreement with an arbitration clause between the parties is governed by state contract law

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[10] "A securities fraud claim under [Florida Statutes Chapter 517] is nearly identical to a securities fraud claim under Rule 10b 5 of the related federal law." *See Ward v. Atlantic Sec. Bank*, 777 So. 2d 1144, 1147 (3d DCA 2001) (citing *Messer v. E.F. Hutton & Co.,* 847 F.2d 673, 676 (11th Cir. 1988)).

(*Schoendorf*, 2009 WL 1075991 at *7), and Florida courts would have refused to compel arbitration under the Scheme Offering Documents due to their illegality, the District Court should have retained control of this matter. By deferring to an arbitrator, the District Court breathed life into an instrument solely used to perpetrate a crime.

IV. AT MOST, ONLY A SMALL PORTION OF THE RECEIVER'S CLAIMS WERE ARBITRABLE

Even ignoring the reasons discussed in this brief for why arbitration was not proper, and assuming *arguendo* the Receiver was required to arbitrate, the District Court also erred in concluding that all claims were arbitrable. In this case (and all of the Receiver's other clawback cases), the Receiver asserted separate FUFTA and, in the alternative, unjust enrichment claims on behalf of each of the six Hedge Funds. *See* Doc. 1. Although the District Court recognized that no defendant claimed to have an arbitration agreement with each of the six Hedge Funds, it still concluded the Receiver must arbitrate all claims, including those asserted on behalf of Hedge Funds that did not have any purported agreement with the pertinent defendant. *See* Doc. 47 at 16; Doc. 42 at 25. That conclusion was wrong because arbitration "is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Howsam*, 537 U.S. at 83.

Each of the six Hedge Funds (including Victory) is a distinct legal entity with its own rights and obligations. *See, e.g.*, *Scholes*, 56 F.3d at 754. The transfers of money that Nadel caused the Hedge Funds to make to the defendants and others as part of his Ponzi scheme injured the Hedge Funds. *See, e.g.*, *id.*; *Grand St. Trust*, 2005 WL 1983879 at *5; *Marwil*, 2003 WL 23095657 at *7; *Freeman*, 865 So. 2d at 551. These transfers injured each Hedge Fund because Nadel operated them as a single Ponzi scheme, commingled their money, and made transfers to the defendants and others from that commingled money. *See* Doc. 1; *Lee*, 2012 WL 6923664 at *8. Further, investors in a Ponzi scheme typically have a claim in the amount of their invested principal (minus any "redemptions"). *See, e.g.*, *In re Bayou Group, LLC*, 372 B.R. 661, 665 (Bankr. S.D.N.Y. 2007). Every transfer of pooled funds to the defendants as part of Nadel's Ponzi scheme depleted invested principal which in turn increased the amount of investors' claims against the Hedge Funds. *See In re McCarn's*, 326 B.R. at 851 (in Ponzi scheme, "returns to investors come from monies obtained from new investors"); *see also In re Ramirez Rodriguez,* 209 B.R. 424, 432 (Bankr. S.D. Tex. 1997) ("enterprise engaged in a Ponzi scheme is insolvent"); *Cunningham v. Brown*, 265 U.S. 1, 8 (1924) (same).

Thus, even if some of the Receiver's claims were arbitrable (*i.e.*, at best the claims asserted on behalf of Victory), the majority of them were not (*i.e.*, the

claims asserted on behalf of the other Hedge Funds) because Mr. Schneiderman only "invested" in Victory and thus only had a purported agreement to arbitrate with Victory. The non-arbitrable claims on behalf of the other Hedge Funds should have proceeded in the District Court. *See Klay*, 389 F.3d at 1204 ("[C]ourts generally refuse to stay proceedings of nonarbitrable claims when it is feasible to proceed with the litigation.").

V. THE DISTRICT COURT ERRED BY REFUSING TO VACATE THE ARBITRATOR'S AWARD

As explained in the preceding sections, this case should not have been compelled to arbitration. As a result of the District Court's Order, however, the Receiver had no choice but to proceed to arbitration, where as explained in the Factual Background, the arbitrator wrongly determined the Receiver's claims against the defendants were barred by the Probate Statutes. The District Court then refused to vacate the arbitrator's Award.

When an arbitrator "strays from interpretation and application of the agreement and effectively dispenses his own brand of industrial justice' … his decision may be unenforceable." *Stolt-Nielsen*, 559 U.S. at 671 (quotation omitted). "In that situation, an arbitration decision may be vacated under § 10(a)(4) of the FAA on the ground that the arbitrator exceeded his powers. . . ." *Id.* at 672 (quotation omitted); *see* 9 U.S.C.A. § 10(a)(4) (award may be vacated "where the arbitrators exceeded their powers, or so imperfectly executed them that

a mutual, final, and definite award upon the subject matter submitted was not made"). While arbitrators are not required to "follow all the niceties observed in federal court," they "must give the parties a fundamentally fair hearing." *See Rosensweig v. Morgan Stanley & Co. Inc.*, 494 F.3d 1328, 1333 (11th Cir. 2007)

Here, the arbitrator improperly "dispens[ed] his own brand of industrial justice" (*Stolt-Nielsen,* 559 U.S. at 671) and exceeded or "so imperfectly executed" his powers because it was clear the Probate Statutes did not bar the Receiver's claims, but he nevertheless ignored the facts, the law, and the parties' arguments and granted the Probate Motion. Indeed, the Receiver filed a motion for reconsideration which detailed the errors in the Award, but the arbitrator reaffirmed the Award without any substantive explanation. *See* Doc. 62, Exs. D & E. By ignoring the facts and refusing to follow the law, the arbitrator breached his obligations as an arbitrator and exceeded his powers. *See* 9 U.S.C.A. § 10(a)(4).

Specifically, assuming *arguendo* a valid contract with an arbitration agreement exists between the parties (*see supra* §§ II & III), that agreement required the arbitrator to provide a reasoned award. *See* Doc. 21 at 2 (requiring "the reasons for their award be stated in a written opinion"). The arbitrator's resolution of the Probate Motion, however, was conclusory and completely ignored the Receiver's primary argument, which was that the Probate Statutes do not apply to claims that arise after a decedent's death. *See, e.g.,* Doc. 62, Ex. C; *Spohr v.*

Berryman, 589 So. 2d 225, 228 (Fla. 1991) (observing express language in Probate Statutes "make clear that it is unnecessary to file a statement of claim ... against the estate that is predicated on events that take place after the decedent's death"); *Coba v. Craig*, 881 So. 2d 733, 733-734 (Fla. 3d DCA 2004); *Thompson v. Hodson*, 825 So. 2d 941, 948 (Fla. 1st DCA 2002); *Swenszkowski v. Compton*, 662 So. 2d 722, 723 (Fla. 1st DCA 1995); *Langford v. Ferrera*, 823 So. 2d 795, 797 (Fla. 1st DCA 2001). The Receiver further showed that a fraudulent transfer claim arises at the time of the transfer, and here the pertinent transfer undisputedly occurred after Mr. Schneiderman's death. *See* Doc. 62, Ex. C; Fla. Stats. § 726.105(1)(a) (regarding a "transfer made") (emphasis added); *Janvey v. Democratic Senatorial Campaign Comm., Inc.*, 712 F.3d 185, 190 (5th Cir. 2013) ("[A] fraudulent-conveyance claim does not accrue until the claimant knew or reasonably could have known both of the transfer and that it was fraudulent in nature."); *Loewer v. New York Life Ins. Co.*, 773 F. Supp. 1518, 1521 (M.D. Fla. 1991) ("There must be some person capable of suing or being sued upon the claim in order for the statute to begin to run."). As such, the Probate Statutes plainly do not apply to the Receiver's fraudulent transfer claims.

In response, the defendants argued that Mr. Schneiderman's purported execution of the Scheme Offering Documents and the allocation of purported "profits" to his alleged "Capital Account" in Victory while he was alive constituted

sufficient pre-mortem activity to bring the Receiver's fraudulent transfer claims within the ambit of the Probate Statutes. Doc. 62, Ex. B at 10. The Receiver then explained (1) that his fraudulent transfer claims were independent of the Scheme Offering Documents (*see Canon Latin Am. Inc. v. Lantech*, 2011 WL 240684, *8 (S.D. Fla. 2011); *Invo Fla., Inc. v. Somerset Venturer, Inc.*, 751 So. 2d 1263, 1266 (Fla. 3d DCA 2000)), and (2) Nadel's purported allocation of alleged profits to investors' Capital Accounts (which did not even exist) was an admitted fabrication at the heart of his Ponzi scheme. The defendants presented no evidence to support their contentions or rebut the Receiver's proof that Nadel operated Victory as a Ponzi scheme and consequently Victory investors had no profits, but the arbitrator simply ignored all of these arguments and granted summary judgment for the defendants. Because the arbitrator failed to address the parties' arguments, the Award was not reasoned and cannot be considered "mutual, final, and definite" under 9 U.S.C.A. § 10(a)(4).

Further, compounding this plain error, the arbitrator treated the Probate Motion as a motion for summary judgment because the defendants claimed the pertinent facts were undisputed. But the defendants submitted <u>no evidence whatsoever</u> in support of the Probate Motion aside from copies of the Scheme Offering Documents. While the date of the pertinent transfer and the date of Mr. Schneiderman's death were undisputed, the defendants relied on factual

arguments about the existence of a purported Capital Account and Nadel's allocation of purported profits to that account during Mr. Schneiderman's lifetime and claimed that those "facts" were sufficient to bring the Receiver's claims within the ambit of the Probate Statutes. The Receiver argued that no such Capital Account actually existed, and even if it did, it was virtually worthless because *inter alia* Mr. Schneiderman's purported profits were completely fabricated. *See* Doc. 62, Ex. C at 15. Moreover, the Receiver explained that, at minimum, he would need to present additional evidence at the final hearing that no such Capital Account existed or that it was virtually worthless before any determination could be made.[11] Although as explained above, the arbitrator did not provide a reasoned or reasonable basis for the Award, he necessarily relied on the defendants' unsupported allegations to grant summary judgment since the pertinent transfer undisputedly occurred <u>after</u> Mr. Schneiderman's death. In short, because (1) the arbitrator was required to render a reasoned award and did not do so, and (2) the arbitrator granted summary judgment based on no evidence – indeed, despite evidence that was inconsistent with defendants' allegations – he exceeded his authority and so imperfectly executed his powers that a mutual, final, and definite

[11] The arbitrator's refusal to hear the Receiver's evidence is an independent ground for vacatur under 9 U.S.C.A. § 10(a)(3) because the arbitrator refused "to hear evidence pertinent and material to the controversy."

award upon the subject matter submitted was not made. As such, the Award should have been vacated.

CONCLUSION

For the foregoing reasons, the Receiver respectfully requests this Court reverse the District Court's order compelling arbitration (Doc. 47) and its order refusing to vacate the Award (Doc. 73). This matter should be remanded to the District Court for a resolution of the Receiver's claims on their merits in that forum.

CERTIFICATE OF COMPLIANCE

I CERTIFY that, excluding the items specified in 11th Cir. R. 32-4, this brief complies with the type-volume limitation set forth in FRAP 32(a)(7)(B)(i). This brief contains 13,924 words. Times New Roman 14 is the type style and size used in this brief.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on May 29, 2014, I filed the foregoing through the Court's ECF system.

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