Securities and Exchange Commission v. Nadel et al Doc. 1352

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

SECURITIES AND EXCHANGE
COMMISSION

Plaintiff,

v.

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

Defendants,

CASE NO.: 8:09-0087-T-26TBM

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

Relief Defendants.
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RECEIVER'S RESPONSE TO WELLS FARGO'S REPLY
IN SUPPORT OF ITS MOTION FOR PAYMENT OF FEES AND COSTS

Burton W. Wiand, as Receiver (the "**Receiver**") for the above-captioned case, hereby files this response to *Wells Fargo's Reply in Support of its Motion for Payment of Fees and Costs [Doc. 1334]* (Doc. No. 1349) (the "**Reply**"), filed by Wells Fargo Bank, N.A. ("**Wells Fargo**") in reply to the *Receiver's Objection to Wells Fargo's Motion for Payment of Certain Fees and Costs as Administrative Expenses* (Doc. No. 1343). In this response (the "**Response**"), provided as a supplement to the *Receiver's Objection to Wells Fargo's Motion for Payment of Certain Fees and*

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Costs as Administrative Expenses (Doc. No. 1343) (the "**Objection**"), the Receiver states as follows:

<u>ARGUMENT IN RESPONSE</u>

1. Wells Fargo Misconstrues the Equitable Exceptions to the American Rule.

A. <u>The Supreme Court's Decision in *Sprague v. Ticonic National Bank* Does Not Create a Broad Equity Receivership Exception to the American Rule.</u>

In its Reply, Wells Fargo seems to argue that the mere existence of a receivership case provides a broad exception to the American Rule, misinterpreting the Supreme Court's holding in *Sprague v. Ticonic Nat. Bank*.[1] *Sprague* does not create a far-reaching exception to the American Rule for all aspects of equity receivership cases. The case is simply a variation of the Supreme Court's long-standing "common fund" exception to the American Rule.

The facts of *Sprague* are important.[2] The petitioner had delivered funds in trust to a bank, which later went into receivership. But the funds on deposit with the bank were secured by earmarked bonds. In the receivership case, the petitioner sought to enforce a lien on the proceeds of the bonds to recover the amount of her trust deposit. The district court granted the petitioner's request to recover on the bond proceeds, and after going up to the Supreme Court on a separate issue, the case was remanded back to the district court. There, the petitioner sought attorney fees. She argued that her litigation efforts had established entitlement to the specific bond proceeds for the benefit of fourteen other similarly situated trusts, and therefore she should be entitled to receive payment of her attorney fees from the bond proceeds, which were "more than sufficient to discharge all trust obligations." *Id.* at 164. The district court denied the request for fees,

[1] 307 U.S. 161, 59 S. Ct. 777, 83 L. Ed. 1184 (1939).
[2] *See generally id.* at 162–63.

determining that it only had authority to strictly follow the Supreme Court's mandate. Most of the opinion addresses that issue—whether the district court had the ability to award attorney fees following remand.[3]

The Court found that it was within the "historic equity jurisdiction of the federal courts" to award fees in that case, as it presented a "variant" of the common fund exception to the American rule where the efforts of an individual "results in a fund for a group though he did not profess to be their representative." *See id.* at 166. The court found that although the petitioner did not create a fund within the common sense, "by establishing her claim [the petitioner] necessarily established the claims of fourteen other trusts pertaining to the same bonds." *Id.*

Wells Fargo attempts to separate *Sprague* from the well-recognized "common fund" exception to the American Rule and recast the case as a far-reaching exception for equity receivership cases. (*See* Reply at 3 ("She was not a class representative and she did not create a common fund")). But examining the facts of the case, and the Supreme Court's statements, show that *Sprague* was indeed decided as a variation of the "common fund" exception. Getting to the heart of the matter, the Court reasoned:

> [W]hen such a fund is for all practical purposes created for the benefit of others, the formalities of the litigation—the absence of an avowed class suit or the creation of a fund, as it were, through stare decisis rather than through a decree—hardly touch the power of equity in doing justice as between a party *and the beneficiaries of his litigation*.

Id. at 167 (emphasis added).

This is the critical point in *Sprague* that is missed by Wells Fargo: under the "common fund" exception, when a litigant's efforts benefit others and result in a fund made available to satisfy the beneficiaries' claims, a court can, in equity, award the litigant attorney fees from the

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[3] *See id.* at 167–70.

fund. A later Supreme Court decision, interpreting *Sprague*, noted that the case "explained that the beneficiaries of the plaintiff's litigation could be made to contribute to the costs of the suit by an order reimbursing the plaintiff out of the defendant's assets from which the beneficiaries eventually would recover."[4] Numerous other Supreme Court cases classify *Sprague* as a typical "common fund" exception case.[5]

Absent in the present case is any discernable benefit conferred by Wells Fargo's litigation upon the creditors of the Receivership estate, or any "fund" made available to creditors as a result of the legal services for which attorney fees are requested. Wells Fargo cannot point to any such benefit in its Reply, only alluding to vague "interests of other hypothetical creditors who also might have been harmed by the Receiver's positions." (Reply at 3). Neither *Sprague* nor any other case cited by Wells Fargo supports awarding attorney fees for advancing undefined "hypothetical" interests. In all "common fund" cases, *tangible* benefits were conferred to other parties from the litigant's efforts. No such benefits are present here. *Sprague* does not apply.

B. Wells Fargo's Asserted "Wrongful Act"/"Negligence" Exception to the American Rule has No Basis in Law.

Wells Fargo asserts that the Supreme Court's *Reading Co. v. Brown*[6] decision created "an important exception to the American Rule." (Reply at 4). This conclusion completely mischaracterizes *Reading*. The case does not mention the American Rule, does not consider an award of attorney fees, and certainly does not "[hold] that a creditor could recover attorneys' fees as a result of a receiver's negligence" as claimed by Wells Fargo. (Reply at 4). For these reasons,

[4] *Hall v. Cole*, 412 U.S. 1, 5 n.7, 93 S. Ct. 1943, 1946 n.7, 36 L. Ed. 2d 702 (1973).

[5] *See, e.g.*, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45, 111 S. Ct. 2123, 2133, 115 L. Ed. 2d 27 (1991) (citing *Sprague* as "common fund exception" case); *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 257–58, 95 S. Ct. 1612, 1621–22, 44 L. Ed. 2d 141 (1975) (citing *Sprague* in listing cases standing for the common fund exception to the American Rule); *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478, 100 S. Ct. 745, 749, 62 L. Ed. 2d 676 (1980) (same).

[6] 391 U.S. 471, 88 S. Ct. 1759, 20 L. Ed. 2d 751 (1968).

the Receiver considered and quickly rebuffed *Reading*'s applicability to this case in his Objection. (Objection at p. 8).

The Receiver does not wish to repeat the statements in his Objection, but it bears emphasis that the key distinguishing factor in *Reading* is that the damages were, in actuality, *damages for negligence*—a tort claim. That is, the claim at issue in *Reading* was a garden-variety negligence claim by a neighboring property owner for fire damage caused by the receiver's negligent operation of estate assets.[7] The Receiver cited several Circuit Court of Appeals cases that distinguish the claims in *Reading* from claims for attorney fees similar to Wells Fargo's. (*See* Objection at p. 15).[8] Wells Fargo mistakenly reads *Reading* to involve a claim for attorney fees. It does not. The case has absolutely no bearing on the American Rule.

Wells Fargo also manufactures a "wrongful act" exception to the American Rule in arguing that the Receiver's "unreasonably litigiousness" supports its claim for attorney fees. (Reply at 4, 7–8). Yet Wells Fargo cites no case law supporting such an exception to the American Rule. As the Receiver stated in his Objection, the Supreme Court has identified narrow exceptions to the American Rule, which "fall into three categories": (1) the common fund exception, discussed *supra*, (2) assessment of fees as a sanction for "willful disobedience of a court order," and (3)

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[7] *See id.* at 473 ("On January 1, 1963, the building was totally destroyed by a fire which spread to adjoining premises and destroyed real and personal property of petitioner Reading Company and others. On April 3, 1963, petitioner filed a claim for $559,730.83 in the arrangement, based on the asserted negligence of the receiver."). "In *Reading,* the claimant was an owner of a neighboring business whose property was damaged by a fire negligently caused by the bankruptcy receiver in the course of operating the debtor's estate during a bankruptcy reorganization." *In re Jack/Wade Drilling, Inc.*, 258 F.3d 385, 389 (5th Cir. 2001) (discussing *Reading*).

[8] *See In re Jack/Wade Drilling, Inc.*, 258 F.3d 385, 387–92 (5th Cir. 2001) (discussing *Reading*); *In re Hemingway Transp., Inc.*, 954 F.2d 1, 5–7 (1st Cir. 1992) (same); *In re Kadjevich*, 220 F.3d 1016, 1019–21 (9th Cir. 2000) (distinguishing *Reading* claims from claims arising from pre-petition conduct, and finding that because the claims at issue "were not caused by any wrongful action of the trustee, they cannot be considered administrative expenses under the "fairness" principle of *Reading Co.*"); *In re Abercrombie*, 139 F.3d 755, 758 (9th Cir. 1998) (discussing *Reading*).

assessment of fees when a party has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons."[9]

None of these categories fit Wells Fargo's allegations. To the extent Wells Fargo is arguing the third exception—that the Receiver acted in "bad faith, vexatiously, wantonly, or for oppressive reasons"—Wells Fargo wholly fails to meet the extraordinary showing required to support an award of attorney fees. This exception "transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself" and is appropriate when a court finds "that fraud has been practiced upon it, or that the very temple of justice has been defiled."[10] The facts in this case certainly do not support such a drastic finding, and no such extraordinary showing has been made by Wells Fargo.

2. Wells Fargo Ignores Analogous Circuit Court of Appeals Bankruptcy Decisions Holding that Attorney Fees Incurred pursuant to Pre-Petition Contracts Are Not Entitled to Administrative Expense Priority.

Even if the claimed attorney fees fall within the language of the loan documents' fee provisions, a point the Receiver disputes,[11] the requested fees would not be entitled to administrative expense priority. To be sure, the contract exception to the American Rule is well recognized. But Wells Fargo's Reply completely ignores the Receiver's argument that in analogous bankruptcy proceedings, attorney fee claims based on pre-petition contracts are not entitled to administrative expense priority. (*See* Objection at 14–16). As this Court well knows, bankruptcy decisions are often looked to as guidance by federal courts in equity receivership actions.

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[9] *Chambers v. NASCO, Inc.*, 501 U.S. 32, 45, 111 S. Ct. 2123, 2133, 115 L. Ed. 2d 27 (1991) (citations omitted).
[10] *Id.* (citing and quoting *Universal Oil Products Co. v. Root Refining Co.,* 328 U.S. 575, 580, 66 S.Ct. 1176, 1179, 90 L.Ed. 1447 (1946)).
[11] Objection to Motion for Turnover (Doc. No. 1342 at pp. 12–14).

In his Objection, the Receiver discusses Circuit Court of Appeals cases supporting the proposition that attorney fees awarded *post*-petition based on a *pre*-petition contract are not entitled to administrative expense priority. (Objection at 14–16). One case in particular, *In re Jack/Wade Drilling, Inc.*,[12] illustrates the doctrine's applicability to the this case.

In *Jack/Wade*, the debtor was party to a pre-petition drilling contract with TMC. The debtor filed bankruptcy, and the chapter 7 trustee sued TMC under for breach of the pre-petition contract. TMC counter-sued and, following a trial, both parties' breach claims were denied. The pre-petition drilling contract contained a prevailing party attorney fee provision; TMC ultimately was deemed the prevailing party. The district court awarded TMC approximately $500,000 in attorney fees and costs, but the bankruptcy court denied TMC's request for administrative expense priority for the award.

On appeal to the Fifth Circuit, the creditor argued that the fees qualified as an administrative expense as an "actual and necessary cost" of the bankruptcy estate.[13] The bankruptcy code does not define "actual and necessary cost," but the courts have generally found that to qualify, "a claim against the estate must have arisen post-petition and as a result of actions taken by the trustee that benefitted the estate."[14] The creditor, like Wells Fargo here, argued that the Supreme Court's *Reading Company v. Brown*[15] decision supported its administrative expense request. The Fifth Circuit soundly rejected that argument, distinguishing the claim for attorney

[12] 258 F.3d 385 (5th Cir. 2001).
[13] *See id.* at 387.
[14] *Id.* at 387; *see In re Hemingway Transp., Inc.*, 954 F.2d 1, 5 (1st Cir. 1992); *see In re EZ Pay Servs., Inc.*, 380 B.R. 861, 864 (Bankr. M.D. Fla. 2007) (finding that to qualify as an administrative expense claim, "it is generally held that the claim must have arisen postpetition and resulted from actions taken by the trustee that created a benefit to the estate").
[15] 391 U.S. 471, 477, 88 S.Ct. 1759, 20 L.Ed.2d 751 (1968).

fees from tort claims in *Reading* which arose from the receiver's negligent operation of estate assets.[16]

The court also rejected the creditor's argument that the fees should receive priority treatment simply because they arose post-petition. The court's findings on this point are directly applicable to Wells Fargo's claimed entitlement to its fees based on its pre-receivership contract:

> The only difference between TMC and the existing creditors of Jack/Wade is that TMC's debt was incurred after Jack/Wade filed for bankruptcy. If Jack/Wade had sued TMC and lost one day before filing for bankruptcy, TMC would be an unsecured creditor with no claim to any priority of payment for its award of attorney fees. *See In the Matter of Al Copeland Enterprises,* 991 F.2d 233, 240 (5th Cir. 1993) (granting administrative expense priority under *Reading* and 503(b)(1)(A) to only the portion of the debt which accrued post-petition). The Court does not find that this fortuity of timing, standing alone, creates a principled basis on which to make an exception to the rule of equal distribution among creditors.[17]

Any claim by Wells Fargo for attorney fees incurred post-receivership based on its pre-receivership contracts with the Defendants or Relief Defendants should not receive administrative expense priority. If the Court borrows bankruptcy courts' definitions of "administrative expense" claims, the "*prepetition* genesis" of a claim for attorney fees based on a pre-petition contract "ultimately distinguishes it from the *postpetition* losses" of the type afforded administrative expense priority.[18] When the "source of the estate's obligation [is] a prepetition fee provision,"

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[16] *See Jack/Wade*, 258 F.3d at 387–92; *see also id.* at 390 n.4 ("The only reason that TMC is able to claim its attorney fees as damages is because of the contractual provision. We cannot equate the injustice that would have resulted to the fire damage victim in *Reading* had it been denied full recovery of its damages with that resulting to TMC in being denied full recovery of its contractual attorney fees and costs.").
[17] *Jack/Wade*, 258 F.3d at 390.
[18] *In re Hemingway Transp., Inc.*, 954 F.2d 1, 7 (1st Cir. 1992) (finding "We are aware of no authority that the *Reading–Charlesbank* exception encompasses a right to payment originating in a prepetition contract with the debtor.").

attorney fees incurred post-petition pursuant to that provision are not entitled to administrative expense priority.[19]

The analysis above directly translates to federal equity receiverships, as both bankruptcy and receivership proceedings share a common primary purpose: "to promote the efficient and orderly administration of estates for the benefit of creditors."[20] Pre-receivership contracts with prevailing party attorney fee provisions entered into between relief defendants (who are likely perpetuating fraud) and third parties should not be permitted to chill a receiver's ability to bring good-faith lawsuits against such third parties. Under Wells Fargo's argument, any equity receiver who sues a party to pre-receivership contract that includes an attorney fee provision would subject the receivership estate to massive potential administrative liability. This result would cut against the receiver's very purpose, to marshal assets for the benefit of defrauded investors and creditors. The Court should look to persuasive appellate court bankruptcy case law and find that, to the extent Wells Fargo's loan documents entitle it to any attorney fees incurred in this receivership case, such attorney fees are not entitled to administrative expense priority.

3. Wells Fargo's Failure to File Proof of Claim Precludes Recovery of Attorney Fees Despite Receiver's Alleged Actual Notice.

As a final point, any supposed actual knowledge the Receiver may have had regarding Wells Fargo's intent to claim prospective attorney fees does not absolve it from filing a proof of claim. The Eleventh Circuit was clear in its holding in *Bendall v. Lancer Mgmt. Grp., LLC*[21]—a party's contingent claim for attorney fees must be asserted through a proof of claim to receive recovery from assets of the receivership estate.[22] Contrary to Wells Fargo's statement in the Reply

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[19] *In re Abercrombie*, 139 F.3d 755, 759 (9th Cir. 1998).
[20] *Bendall v. Lancer Mgmt. Grp., LLC*, 523 F. App'x 554, 557 (11th Cir. 2013).
[21] 523 F. App'x 554, 557 (11th Cir. 2013).
[22] *See id.* at 558–59.

(Reply at 9), the Eleventh Circuit's ruling in the Claims Litigation did not absolve Wells Fargo from filing a proof of claim to recover from receivership assets. The court simply held that the failure to file a proof of claim did not act to deprive Wells Fargo of its "secured state-law property right that existed prior to the receivership."[23] In fact, the Eleventh Circuit expressly stated that a secured creditor must file a proof of claim before it become entitled "to access of the general pool of receivership assets for any unsecured portion of its debt."[24]

This is precisely what Wells Fargo seeks—it seeks payment of its attorney fees from the general pool of receivership assets. What's more, Wells Fargo asks the Court to elevate its claim *above* defrauded investors and creditors (who timely filed proofs of claim). As stated in the Objection, Wells Fargo failed to file the required proofs of claim for attorney fees.[25] Further, as discussed above and further in the Objection, even if it had filed a proof of claim for attorney fees, such a claim still is not entitled to administrative expense priority.

CONCLUSION

For all of the reasons stated in the Objection, as supplemented by this Response, the Court should deny Wells Fargo's request for an administrative claim

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[23] *Sec. & Exch. Comm'n v. Wells Fargo Bank, N.A.*, 848 F.3d 1339, 1345 (11th Cir. 2017).
[24] *Id.* "As the district court correctly noted, there is a distinction between a secured creditor's *in rem* rights to the collateral and its right to receive a distribution for the general pool of receivership assets." *Id.* at n.5.
[25] Even if the proof of claim filed by Wells Fargo as to the Rite-Aid Property were deemed sufficient as to future attorney fees, Wells Fargo's fee request fails to separate out which fees expressly related to services in connection with the Rite-Aid Property.

CERTIFICATE OF SERVICE

I hereby certify that on January 26, 2018, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system.

/s/ Susan Heath Sharp
Susan Heath Sharp