Securities and Exchange Commission v. Nadel et al Doc. 714

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v. Case No. 8:09-cv-87-T-26TBM

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

Defendants,

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

Relief Defendants.
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RECEIVER'S REPLY TO WELLS FARGO BANK, N.A.'S OBJECTION TO RECEIVER'S MOTION TO (1) APPROVE DETERMINATION AND PRIORITY OF CLAIMS, (2) POOL RECEIVERSHIP ASSETS AND LIABILITIES, (3) APPROVE PLAN OF DISTRIBUTION AND (4) ESTABLISH OBJECTION PROCEDURE (DOC. 689)

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Burton W. Wiand, as Receiver (the "**Receiver**"), filed a motion relating to claims determinations and the claims process (the "**Motion**") (Doc. 675). Among the claims addressed in the Motion was one submitted by Wells Fargo Bank, N.A. ("**Wells Fargo**") as successor to Wachovia Bank, N.A. ("**Wachovia**"), relating to real estate located at 841 South Main Street, Graham, North Carolina, which houses a Rite Aid drugstore (the "**Rite Aid Property**"). Specifically, the claim relates to a loan Wachovia made to Receivership Entity Scoop Real Estate, L.P., secured by the Rite Aid Property, and it should be denied for several reasons. *See* Mot. at 55-59.

Wells Fargo filed an objection to the Motion (the "**Objection**") (Doc. 689). It objected to various matters, only one of which, although lacking any merit, was properly lodged at this time. That objection is to the Proposed Objection Procedure. The rest of its objections target the merits of the Receiver's (i) claim determination and (ii) claim priorities, and thus should be made as part of the objection procedure ultimately adopted by the Court, and not now in piecemeal fashion. Indeed, addressing these two objection categories in an efficient manner is part of the very reason for the Receiver's Proposed Objection Procedure.

I. IN THE MOTION, THE RECEIVER RECOMMENDS DENIAL OF WELLS FARGO'S CLAIM; HE DOES NOT ASSERT AFFIRMATIVE CLAIMS AGAINST WELLS FARGO

Wells Fargo argues the Proposed Objection Procedure absolves the Receiver of the need to prove his claims against Wells Fargo and impermissibly shifts the burden of proof from the Receiver to Wells Fargo. Obj. 13-15. In support of its argument, Wells Fargo relies entirely on the Bankruptcy Code, and it ignores that this is an equity receivership involving a

Ponzi scheme, not a bankruptcy proceeding.[1] As *Marion v. TDI, Inc.*, 2006 WL 3742747, *2 (E.D. Pa. 2006), observes, "a bankruptcy proceeding differs significantly from an equity receivership imposed at the request of a government agency such as the SEC. The whole purpose of the SEC proceeding is to remedy violations of the securities laws for the benefit of investors."

More importantly, Wells Fargo's argument misses the point because, in the Motion, the Receiver does not assert any claims against Wells Fargo. Instead, the Receiver recommends that the Court deny Wells Fargo's claim due to, among other reasons, Wells Fargo's knowledge of "red flags" and other improprieties and its consummation of numerous improper transactions which were part of Nadel's scheme. The Receiver need only demonstrate that denial of the claim would be "fair and equitable." *See SEC v. Elliot,* 953 F. 2d 1560, 1566 (11th Cir. 1992) (court has "broad powers and wide discretion" to assure equitable distributions); *SEC v. P.B. Ventures,* 1991 WL 269982, *2 (E.D. Pa. 1991) (method of distribution should simply be "fair and equitable"); *SEC v. Credit Bancorp, Ltd.*, 2000 WL 1752979, *28 (S.D.N.Y. 2000) ("An equitable plan is not necessarily a plan that everyone will like."). Wells Fargo attempts to convert the Receiver's claim determination, which is governed by equity, into freestanding litigation or a bankruptcy proceeding. In doing so, Wells Fargo improperly reverses the applicable burden of proof and ignores that this claims

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[1] Wells Fargo's attempt in footnote 2 of its Objection to argue that it holds valid secured claims in connection with properties for which it never filed proofs of claim in the Receiver's claims process similarly relies on bankruptcy rules that do not apply here. Pursuant to the Court's order establishing the claims process and relevant authorities, the failure to file a proof of claim is a complete bar to recovery. *See Callahan v. Moneta Capital Corp.,* 415 F.3d 114, 117-18 (1st Cir. 2005); *SEC v. Princeton Econ. Int'l Ltd.,* 2008 WL 7826694, *4 (S.D.N.Y. 2008); *CFTC v. Wall St. Underground, Inc.,* 2007 WL 1531856, *4 (D. Kan. 2007).

process is focused on defrauded investors.[2] *See U.S. v. Penny Lane Partners, L.P.*, 2010 WL 5796465, *6 (D.N.J. 2010) (holding that claimant must show entitlement to recovery and "prove his or her claim satisfactorily prior to obtaining recovery") (R&R adopted at 2011 WL 550883); *SEC. v. Mutual Benefits Corp.,* Case No. 0:04-cv-60573, Order Granting Receiver's Mot. For Final Determination Of Allowed Claims at 3 (S.D. Fla. 2008) (attached as **Ex. K** to Mot.) ("[T]his is an SEC enforcement action designed to protect the *investors*, not the creditors....").

II. THE RECEIVER HAS STANDING TO ASSERT CLAIMS AGAINST WELLS FARGO

Next, Wells Fargo argues the Receiver lacks standing to assert tort claims on behalf of third-party investors. This too misses the point and, in any event, mischaracterizes the claims the Receiver has against Wells Fargo. It misses the point because, as explained above, the Receiver did not assert affirmative claims against Wells Fargo in the Motion. Rather, the Receiver recommended the Court deny Wells Fargo's claim on equitable grounds. But even putting that to the side, the argument fails because it mischaracterizes the Receiver's intentions: the Receiver does not intend to assert claims against Wachovia on behalf of "investor;" rather, he will sue on behalf of Receivership Entities as he has done in every case he has filed.

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[2] For example, Wells Fargo argues that, under the Bankruptcy Code, its claim should be deemed *prima facie* valid. But as noted above, the Bankruptcy Code does not apply here. Further, there is no reason to deem Wells Fargo's claim "*prima facie* valid" because the Motion sets forth procedures pursuant to which Wells Fargo can provide the Receiver with evidence supporting the validity of its claim, and should the parties disagree, Wells Fargo and the Receiver will submit their dispute and evidence to the Court following an objection period.

Unquestionably, the Receiver has standing to assert claims on behalf of Receivership Entities. *See, e.g.*, *Obermaier v. Arnett*, 2002 WL 31654535, *3 (M.D. Fla. 2002) (receiver lacks standing to assert claims on behalf of defrauded investors, but has standing to assert claims on behalf of receivership entities); *In re Burton Wiand R'ship Cases Pending in the Tampa Div. of the Middle Dist. of Fla.*, 2008 WL 818504, *5-6 (M.D. Fla. 2008) (same); *Perlman v. Wells Fargo Bank, N.A.*, 2011 WL 5873054, *3-4 (S.D. Fla. 2011) (same). Of course, if successful, the Receiver's claims will benefit Receivership Entities' investors who suffered losses, but that is inconsequential when considering standing. *See Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995) ("That the return would benefit the [investors] . . . is just to say that anything that helps a corporation helps those who have claims against its assets."); *Quilling v. Grand Street Trust*, 2005 WL 1983879, *5 (W.D.N.C. 2005) ("While the [receiver's] Complaint alleges that investors were ultimately harmed and defrauded by [the scheme's perpetrator] ..., the [fraudulent transfer] claims are brought on behalf of [a receivership entity] ...."); *Marwil v. Farah*, 2003 WL 23095657, *5-6 (S.D. Ind. 2003) ("[F]raud on the receivership entity that operates to its damage is for the receiver to pursue ... and to the extent that investors ... may ultimately benefit from such pursuit ... does not alter the proposition that the receiver is the proper party to enforce the claim ....").

Contrary to Wells Fargo's contentions, *Freeman v. Dean Witter Reynolds, Inc.*, 865 So. 2d 543 (Fla. 2d DCA 2003), and recent decisions in the Bernard Madoff bankruptcy do not support its Objection. *Freeman* simply held the defendant banking institution in that case did not owe a fiduciary duty to the plaintiff because the parties shared nothing more than a debtor-creditor relationship. *Id.* at 549. Here, as described in the Motion, among other

things, Wells Fargo and Nadel had an extensive relationship, Wachovia was aware of numerous "red flags" and other improprieties, Wachovia consummated numerous transactions which furthered Nadel's scheme, and it even was invested in two of Nadel's hedge funds. As such, Wells Fargo's relationship with Nadel was not typical, and the facts at issue here are far more similar to those in *Perlman* than *Freeman*. *See Perlman*, 2011 WL 5873054 at *8-16 (denying Wachovia's motion to dismiss receiver's claims for aiding and abetting breach of fiduciary duty, aiding and abetting conversion, and violations of FUFTA, and noting receiver also had claim for breach of contract). Similarly, Wachovia's broad contention (Obj. 6-7) that dismissal of claims brought by the Madoff trustee against financial institutions shows that the equity Receiver here has no claims against Wachovia is plainly untrue. There are significant factual distinctions between the Madoff cases and the Receiver's dispute with Wachovia. And there are also significant legal distinctions: the Madoff trustee and the court in that matter operate within the parameters of the Bankruptcy Code and the Securities Investor Protection Act, but the equity Receiver here and this Court are governed by equity.

III. THE *IN PARI DELICTO* DOCTRINE DOES NOT APPLY TO THE RECEIVER

Wells Fargo also argues the Receiver's "claims" are barred by the *in pari delicto* doctrine. Obj. at 8. Again, the Receiver does not assert any "claims" in the Motion, and instead recommends denial of Wells Fargo's claim on equitable grounds. As such, the *in pari delicto* doctrine simply does not apply.[3] But even if the Receiver had asserted claims

[3] Indeed, as Wells Fargo recognizes, "[t]he doctrine of *in pari delicto* is based on the policy that courts should not lend their good offices to mediating disputes among wrongdoers ...." Obj. at 7 (quotation omitted).

against Wells Fargo, the doctrine still would not apply to the Receiver's claims for two independent reasons.[4]

First, the *in pari delicto* defense may not apply at all to equity receivers such as the Receiver here. *See, e.g.*, *Perlman*, 2011 WL 5873054 at *7-8 ("[E]ven if it were apparent from the pleadings that the *in pari delicto* defense would have applied to bar Plaintiff's claims had they been asserted by the receivership entities themselves, the Court is unclear as to whether, under Florida law, the appointment of a receiver causes the *in pari delicto* defense to lose its sting."). This approach is already followed by several jurisdictions. *See, e.g., Scholes v. Lehmann,* 56 F.3d 750, 754 (7th Cir. 1995).

Second, even if it does apply to receivers, it does not apply when, like here, the receivership entities on whose behalf claims are brought had innocent stakeholders. *See, e.g.*, *Freeman*, 865 So. 2d at 551 ("[W]hen the entities in receivership do not include a corporation that has ... an innocent stockholder, we do not perceive a method to separate the fraud and intentional torts of the insiders from those of the corporation itself."); *In re Wiand*, 2007 WL 963165, *6-7 (M.D. Fla. 2007) (noting that *in pari delicto* defense may bar receivers from pursuing damages claims only in "cases where there is not at least ... an innocent stockholder").

The Receiver's claims process is not a "dispute among wrongdoers." Rather, it is an equitable proceeding for allocating scarce resources among innocent investors who were defrauded by Nadel.

[4] Wells Fargo assumes the Receiver would only assert common law tort claims against it, but the Receiver likely will also assert fraudulent transfer claims, which are never subject to an *in pari delicto* defense. *See, e.g.*, *In re Wiand*, 2007 WL 963165, *7 (M.D. Fla. 2007) ("[T]he defense of *in pari delicto* does not bar a FUFTA claim by the Receiver ...."); *Perlman*, 2011 WL 5873054 at *7-8.

Here, Nadel operated a Ponzi scheme through the hedge funds underlying this case, and each of those funds was organized as a limited partnership or limited liability company. Investors in the hedge funds purchased limited partnership or limited liability company interests, as applicable, and became equity holders. Many of them, if not most of them, were innocent and not on inquiry notice of fraud under applicable law. As such, the hedge funds had many innocent stakeholders whose existence bars application of the *in pari delicto* defense under Florida law to claims brought by the Receiver on behalf of the hedge funds. *See Wiand, as Receiver v. Holland & Knight LLP et al.*, Case No. 2009-CA-014887-CA (Fla. Cir. Ct.) (rejecting application of *in pari delicto* defense because "we have innocent stockholders here"), a copy of which is attached here as Exhibit A.

IV. EQUITABLE SUBORDINATION IS PROPER

Wells Fargo also argues the Receiver's equitable subordination "claim" is without merit because subordination is an "extreme remedy," and Well Fargo's conduct does not rise to the requisite level of culpability. Mot. at 8-9. Specifically, Wells Fargo contends the Receiver's claim that its ignorance of "red flags" is purportedly "more akin to negligence claims" than fraud. *Id.* at 9. Although it is not necessary to delve into specifics at this time because this too is a matter that should be addressed after an objection period, in reality, the full extent of Wachovia's conduct constitutes, at a minimum, severe recklessness rather than mere negligence. In this Circuit, severe recklessness is equivalent to fraudulent intent under the securities laws. *See, e.g., Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1284-84 (11th Cir. 1999) (holding that Private Securities Litigation Reform Act did not alter "the well-

established judicial rule that scienter could be alleged adequately by pleading facts denoting reckless behavior").

"Courts equitably subordinate claims when the claimant has engaged in some type of inequitable conduct and the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant." *Picard v. Katz*, 2011 WL 4448638, *6 (S.D.N.Y. 2011) (internal quotations omitted). "Inequitable conduct encompasses conduct that may be lawful but is nevertheless contrary to equity and good conscience." *Id.* (internal quotation omitted). Here, as explained in the Motion, Wachovia ignored numerous improprieties and consummated numerous improper transactions which allowed Nadel to perpetrate his Ponzi scheme. Mot. at 55-57. This conduct certainly "resulted in injury to the creditors" of the hedge funds. *Picard*, 2011 WL 4448638 at *6. "Subordination is an equitable power and is therefore governed by equitable principles." *In re Westgate Cal. Corp.*, 642 F.2d 1174, 1177 (9th Cir. 1981). Equity demands that the claims of innocent investors who had no knowledge of Nadel's scheme receive priority over those of a sophisticated financial institution that had a broad relationship with Nadel filled with "red flags" and improper transactions which furthered Nadel's scheme. *See, e.g., In re Bernard L. Madoff Inv. Secs. LLC,* 2011 WL 4434632, *19-20 (Bankr. S.D.N.Y. 2011); *Picard*, 2011 WL 4448638 at *6.

V. THE PROPOSED OBJECTION PROCEDURE SATISFIES DUE PROCESS

Wells Fargo contends the procedures proposed in the Motion violate due process. This argument is substantively identical to one in an objection (Doc. 677) filed by LandMark Bank ("**LandMark**"), except that Wells Fargo requests 120 days to respond to the Receiver's

claim determination whereas LandMark "only" requested 90 days. Both LandMark and Wells Fargo also argue they should have six months of discovery and a full-blown trial with all pre-trial disclosures. In his reply (Doc. 692) to LandMark's objection, the Receiver explained that the Proposed Objection Procedure conserves judicial and Receivership resources and comports with due process. *See Elliott*, 953 F.2d at 1566. Because they are substantively identical, Wells Fargo's due process objection should be overruled for the reasons set forth in the Receiver's reply to LandMark's objection. *See* Doc. 692.

VI. THE RECEIVER'S PRIORITY OF DISTRIBUTION IS EQUITABLE AND FAIR

Finally, Wells Fargo argues the priority scheme set forth in the Motion is "illogical, unfair and inequitable" because the investors in the hedge funds "assumed the risk of their investments," whereas secured and unsecured creditors did not.[5] In support of its argument, Wells Fargo relies entirely on the Bankruptcy Code. *See* Obj. at 15-17. But, again, this is not a bankruptcy proceeding: investors in Ponzi schemes do not assume the risk of fraud, and when investors fall victim to such schemes, the federal securities laws provide them with recourse and, often, compensation. *See Marion*, 2006 WL 3742747 at *2 ("The whole purpose of the SEC proceeding is to remedy violations of the securities laws for the benefit of investors.").

Further, Wells Fargo ignores the authorities the Receiver cited in the Motion in support of the proposed priority scheme, all of which involved equity receiverships. As those

[5] Importantly, Well Fargo lacks standing to object to the priority scheme on behalf of general creditors. It is not a general creditor, and it is not entitled to assert a deficiency claim as a general creditor. *See* III Clark on Receivers § 660(a) at 1155 (Anderson 3d ed. 1959); *SEC v. Byers,* 637 F. Supp. 2d 166, 183 (S.D.N.Y. 2009) (adopting distribution plan which "only permit[ted] secured creditors to recover out of their collateral" and "prohibit[ed] them from recovering under the [p]lan for their deficiency claims").

authorities demonstrate, investors should receive priority over general and secured creditors – and especially over creditors like Wells Fargo that had inquiry or actual notice of fraud. *See, e.g., Quilling v. Trade Partners, Inc.*, 2006 WL 3694629, *1 (W.D. Mich. 2006) ("As an equitable matter in receivership proceedings arising out of a securities fraud, the class of fraud victims takes priority over the class of general creditors with respect to proceeds traceable to the fraud."); *Byers,* 637 F. Supp. 2d at 184 ("The Receiver's proposal to treat differently those involved in the fraudulent scheme when distributions are being made is eminently reasonable and is supported by caselaw."); *P.B. Ventures,* 1991 WL 269982 at *2 (No specific method of distribution is required; the method of distribution should simply be "fair and equitable."); *SEC v. HKW Trading LLC,* 2009 WL 2499146, *3 (M.D. Fla. 2009); *SEC v. Megafund Corp.*, 2007 WL 1099640, *2 (N.D. Tex. 2007) (holding that general creditors "will not be paid until all defrauded investors are fully compensated"); *C.F.T.C. v. PrivateFX Global One*, 778 F. Supp. 2d 775, 786-87 (S.D. Tex. 2011) (overruling objection of bank that extended line of credit and adopting receiver's argument that "courts regularly grant defrauded investors a higher priority than defrauded creditors").

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on January 17, 2012, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system.

I FURTHER CERTIFY that on January 18, 2012, I will mail the foregoing document and the notice of electronic filing by first-class mail to the following non-CM/ECF participants:

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