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HEADNOTE: HOW TO DEAL WITH WHISTLEBLOWERS PROVISIONS
Steven A. Meyerowitz **193**

STRATEGIC RESPONSES TO THE WHISTLEBLOWER PROVISIONS OF THE DODD-FRANK ACT
Daniel A. Feinstein, Ralph W. Norton, David Fisher, and Jason E. Pruzansky **195**

EMBEZZLEMENT
Frank W. Abagnale **208**

ASSET HUNTING AND ANTI-MONEY LAUNDERING: JUSTICE ON THE TRAIL OF TEARS
Michael Diaz, Jr., Carlos F. Gonzalez, Sumeet H. Chugani, and Xingjian Zhao **219**

JUDGE REJECTS PROPOSED FINE IN ABB FCPA PROSECUTION
Bruce E. Yannett and Aaron M. Tidman **226**

INTERNAL INVESTIGATIONS: *UPJOHN* WARNINGS ARE REQUIRED
Angelo A. Stio III and Michael T. Pidgeon **232**

CODES OF BUSINESS CONDUCT AND WHISTLEBLOWING PROCEDURES IN FRANCE: THE FRENCH DATA PROTECTION AUTHORITY AMENDS THE REGULATORY FRAMEWORK
Myria Saarinen and Matthias Rubner **237**

INVESTORS AND EMPLOYEES AS RELIEF DEFENDANTS IN INVESTMENT FRAUD RECEIVERSHIPS: PROMOTING EFFICIENCY BY FOLLOWING THE PLAIN MEANING OF "LEGITIMATE CLAIM OR OWNERSHIP INTEREST"
Jared Wilkerson **243**

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Investors and Employees as Relief Defendants in Investment Fraud Receiverships:
Promoting Efficiency by Following the Plain Meaning of "Legitimate Claim or Ownership Interest"

JARED WILKERSON

Relief defendants are nominal, innocent parties who hold funds traceable to the receivership but have no legitimate claim or ownership interest in them. These nominal parties, as opposed to full or primary defendants, have no cause of action asserted against them, and if they show no legitimate claim to the funds traced to the receivership, the funds are disgorged — generally at summary judgment. This seemingly simple relief defendant tool is used by receivers and regulatory agencies to quickly recover receivership funds for ultimate distribution to creditors. Recently, however, conflict has arisen in federal courts concerning the meaning of "legitimate claim or ownership interest." Where courts fail to uphold the plain meaning of those words, confusion and unpredictability ensue, leading to enormous costs for creditors as receivers, on the receivership's dime, attempt to claw back funds from relief defendants. To prevent such unnecessary costs in the future, the plain meaning of "legitimate claim or ownership interest" must be reinforced to protect, at minimum, the amount of investors' returned principal and the amount of employees' reasonable compensation.

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Imagine yourself as one of the tens of thousands of investors holding a certificate of deposit from Stanford International Bank in early 2009. The CD has the blessing of the SEC and CFTC and has performed beautifully for about 15 years. The broker-dealer, Stanford Group Company ("SGC"), is a member of SIPC and the whole operation, with its lavish headquarters in Houston and offices around the world, appears perfectly prosperous. Yet on February 17, 2009, you receive news that FBI agents have stormed SGC headquarters in an SEC investigation alleging fraud or even a Ponzi scheme at Stanford, and that the federal court for the Northern District of Texas has appointed a receiver, Dallas attorney Ralph Janvey, to clean up the growing insolvency mess.[1] Most importantly, you discover that your SGC brokerage account with a New Jersey holding company has been frozen.[2] Within days, the receiver hires an army of attorneys and accountants who all start billing their time to the receivership.[3] You, confused and worried by the affair, wonder what will happen next.

Within days, Janvey sends you a demand letter saying that he wants all of your Stanford investment money, both principal and interest, for a pool that will give all investors a low pro rata distribution. You are stunned that the receiver would suggest that you simply hand over your contractual returns, especially since he is attempting to gain access to CD proceeds not only in your brokerage account, but also money sitting in your bank account, money that made your mortgage payments last year, and money that paid your daughter's college tuition. You storm to your SGC financial advisor to find out what he knows and to ask him why he allowed you to invest in a fraud. He, who has also invested in the CD, tearfully promises that he knows nothing of the alleged fraud and says that the receiver plans to claw back all of his commissions, salary, and employee forgivable loans related to CD sales.[4] He also tells you that the receiver has fired him and all other advisors.[5] Worst of all, he says, the receiver plans to pursue

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both investors and advisors as "relief defendants" — a classification that will largely prevent you from defending yourself, even though the receiver does not claim that you did anything wrong.[6] Now, confused more than angry, you hasten immediately to your attorney.

This ugly scene, slightly fictionalized, demonstrates the uncertainty facing innocent investors and employees in Ponzi schemes and other investment fraud cleanups.[7] Most starkly displayed in the $8 billion Stanford matter, the idea of treating investors and employees as though they had no legitimate claim to their funds has been around for some time. Conversation on this issue has spread on news sites and through the blogosphere, but there is a surprising lack of academic literature examining the pros and cons of what seems at times to be either self-serving or capricious receiver action. This article clarifies and directs the conversation and will help prevent abuse of investors and employees in the future. The article begins with an introduction to and brief history of relief defendants — nominal parties who hold receivership funds but have no legitimate claim to them — in investment frauds.

Though the relief defendant concept is becoming well-known, it has been a contested legal concept for decades in fraud cleanups. Indeed, receivers, trustees, and judges have diverse opinions on whether investors and employees should ever be proper relief defendants and, if so, the amount of investment proceeds a receiver can claw back from them.[8] Thus, the law of relief defendants is economically inefficient because it is unpredictable. Some problematic reasoning has already led to harsh outcomes for two of the most attractive clawback targets for receivers cleaning up financial frauds: investors and employees. In particular, the following should be antithetical to the law of relief defendants: (1) that investors, as relief defendants, can be made to disgorge the amount of principal they invested;[9] and (2) that employees, as relief defendants, can be made to disgorge their reasonable remuneration.

The basis of these problems is a misunderstanding or misconstruction of "legitimate claim or ownership interest," which is the key to determining whether a party is a proper relief defendant or must be pursued as a "full defendant," that is, as a party whose unjust enrichment, receipt of a fraudulent conveyance, or other participation in or benefit from the fraud

allows for a cause of action (with its panoply of defenses) against her. This article next introduces these two problems by way of a few salient cases. After each problem, the obvious solution is discussed: to reinforce the idea that investors have a legitimate claim to their principal and that employees have a legitimate claim to their reasonable remuneration — even in Ponzi schemes. Clarification of the status of investors and employees will not only minimize economic hardship on innocent parties, but will also reduce the time that receivers (and defense attorneys) spend litigating, thereby leaving more of the receivership estate for distribution to creditors.

The legal problems then are illustrated, where the Stanford case is used to display the consequences of disregarding the plain meaning of "legitimate claim or ownership interest." In that case, the receiver and his contingent of professional billers burned through money meant for investors and other creditors while fruitlessly pursuing other innocent investors and employees as relief defendants. If the relief defendant concept had been clearer, this likely would not have happened. Adhering to the plain definition of "legitimate claim" will lead to predictability and efficiency by discouraging unnecessary litigation, maintaining the size of the receivership estate, and providing for an earlier distribution of receivership funds to creditors. Receivers, incentivized by the pool of money sitting in receivership, will probably continue to push the envelope even after these particular problems are finally settled, but perhaps by helping to focus the discussion surrounding relief defendants in investment frauds, investors and employees will be saved from needless and costly attacks by misguided receivers.

A BRIEF HISTORY OF RELIEF DEFENDANTS IN INVESTMENT FRAUD RECEIVERSHIPS

A federal receivership in a securities fraud case is essentially the equity-based version of a bankruptcy trusteeship.[10] That is, the receiver, appointed as an officer of the court,[11] steps into the shoes of the directors and managers of the accused entity for the benefit of creditors — who begin to queue shortly after the receiver's appointment. Rather than the web of bankruptcy code rules governing trustee behavior, receivers are governed

by broad equitable principles as defined in the receiver's appointment order. Indeed, the need for equity and flexibility is identified in Federal Rule of Civil Procedure 66, which states that:

> These rules govern an action in which the appointment of a receiver is sought or a receiver sues or is sued. But the practice in administering an estate by a receiver or a similar court-appointed officer must accord with the historical practice in federal courts or with a local rule. An action in which a receiver has been appointed may be dismissed only by court order.

By handing decision-making in administration of the entity in receivership to courts following the "historical practice" of other courts, the drafters of the Federal Rules recognized the need to leave this area to case-by-case analysis and common law development. Although the common law does structure receivership dealings and precedent is important, "The district court has broad powers and wide discretion to determine relief in an equity receivership."[12]

The principles governing equity receivers are usually reflected in the receiver's appointment order by the trial court handling the enforcement matter.[13] Ordinarily, appointment orders broadly state that the receiver's duty is to retain and recover assets of the entity in receivership for the benefit of the creditors of that entity.[14]

Relief Defendants

Relief defendants are "part[ies] to an action who ha[ve] no control over it and no financial interest in its outcome…."[15] Since relief defendants, mere custodians or gratuitous recipients of funds, have no stake in the outcome and are accused of no wrongdoing or unjust enrichment, receivers can, by summary judgment, disgorge funds from them without asserting a cause of action as long as the relief defendants cannot show a legitimate claim to the funds.

By contrast, full defendants are parties who must be given full service of process, pursued under some cognizable cause of action, and must be afforded the ability to fully litigate his liability under that cause of action.[16]

Naming a party as a relief defendant cannot be used as a quick way of obtaining disgorgement from a party if that party has an interest in the funds or is a wrongdoer; such parties do not fit the definition of a relief defendant and must be pursued as full defendants under some cause of action that affords full defensive rights.[17]

In the receivership context, the procedural tool known as a "relief" or "nominal" defendant is one who:

> [H]as no ownership interest in the property that is the subject of litigation but may be joined in the lawsuit to aid the recovery of relief. A relief defendant is not accused of wrongdoing, but a federal court may order equitable relief against such a person where that person (1) has received ill-gotten funds, and (2) does not have a legitimate claim to those funds…. A "nominal defendant" is a person who can be joined to aid the recovery of relief without an additional assertion of subject matter jurisdiction only because he has no ownership interest in the property which is the subject of litigation. Because a nominal defendant has no ownership interest in the funds at issue, once the district court has acquired subject matter jurisdiction over the litigation regarding the conduct that produced the funds, it is not necessary for the court to separately obtain subject matter jurisdiction over the claim to the funds held by the nominal defendant; rather, the nominal defendant is joined purely as a means of facilitating collection. In short, a nominal defendant is part of a suit only as the holder of assets that must be recovered in order to afford complete relief; no cause of action is asserted against a nominal defendant.[18]

Often — and particularly when there are many relief defendants — the court will institute summary proceedings to decide whether the relief defendants have a legitimate claim to the funds they hold and, if they do not, to quickly disgorge the funds.[19] There is no need for relief defendants to show exclusive ownership of the disputed funds to avoid disgorgement; they must generally show only some legitimate claim or ownership interest (beyond mere possession) to prevent summary disgorgement.[20] In plain language, a "legitimate claim" is merely "any right to payment… *even if contingent*

or provisional" that is lawful, genuine, or valid;[21] an ownership "interest" is simply a "legal share in [ownership]; all *or part* of a legal or equitable claim to or right in property."[22] An innocent employee who earns remuneration and can show that the remuneration is reasonable — that is, that the payment does not so far outweigh services rendered so as to become a gift or mere transfer of funds — clearly has a legitimate claim, arising out of the employment relationship, to the compensation. Likewise, an innocent investor always has a legitimate claim to investment returns up to the amount of her principal invested, and, in many situations — such as when debt holders are contractually promised a fixed rate of return — investors must be seen to have a legitimate claim to interest as well.

The quintessential relief defendant is a bank or a trustee holding funds on behalf of others, the addition of whom as a nominal party has no effect on jurisdiction.[23] For example, in *SEC v. Absolutefuture.com*,[24] defendants, after acquiring funds fraudulently, placed those funds into an account with relief defendant Exchange Bank & Trust, Inc. Since the relief defendant was merely holding funds that, for its purposes, belonged to someone else, it had no legitimate claim or ownership interest in them.

The relief defendant concept, though very simple on its face, has not had much time to develop, so it is perhaps understandable that the courts have varied so widely in its application. True, the SEC began using the nominal defendant concept in a limited way decades ago, using it as a tactic to add a needed party, such as the corporation itself, which would often align itself with the SEC's position.[25] Today, however, relief defendants are used in cases initiated by the SEC, CFTC, and other agencies as a means of quickly obtaining funds that belong to the receivership but are being held by someone else in a merely custodial or possessory capacity.[26] Reaching this point, which is still unstable, has taken time. One major turning point was *SEC v. Cherif*, which demonstrated that the stage was set by 1991 to use the relief defendant tool not just as a means of adding entities as procedurally nominal parties but for clawbacks against individuals who had received funds originally obtained by fraud.[27] The court in *Cherif*, faced with a nominal defendant who might well have provided services in return for compensation, inadvertently gave birth to confusion, and parties on both sides of the debate on the breadth of the relief defendant tool use

Cherif to bolster their position.

In that case, defendant Danny Cherif, an ex-employee of a Chicago bank, used his still-functional employee magnetic identification card to enter the firm's building outside working hours, obtain confidential information about the bank's corporate clients, and then trade on the stock market using that information before it went public.[28] As part of his scheme, he opened a brokerage account in the name of his brother-in-law, nominal defendant Khaled Sanchou. The SEC obtained a preliminary freeze on the account and sought to disgorge any money from it that was connected to Cherif's fraud.[29] Sanchou argued that the freeze must be lifted because the district court had no jurisdiction over him. The Seventh Circuit held that subject matter jurisdiction would not be a problem for the SEC if Sanchou truly was a nominal defendant:[30]

> Because the nominal defendant is a "trustee, agent, or depositary," who has possession of the funds which are the subject of litigation, he must often be joined purely as a means of facilitating collection. The court needs to order the nominal defendant to turn over funds to the prevailing party when the dispute between the parties is resolved. A nominal defendant is not a real party in interest, however, because he has no interest in the subject matter litigated. His relation to the suit is merely incidental and "it is of no moment [to him] whether the one or the other side in [the] controversy succeed[s]." Because of the non-interested status of the nominal defendant, there is no claim against him and it is unnecessary to obtain subject matter jurisdiction over him once jurisdiction over the defendant is established.[31]

Noting that the factual record was insufficient to conclude that Sanchou had no hand in the scheme or otherwise was an uninterested party, the Court remanded and said that the district court should come to one of two conclusions: either that (1) Sanchou was an innocent custodian of the funds, in which case he would be a proper relief defendant and subject matter jurisdiction would be irrelevant; or that (2) Sanchou had a hand in Cherif's scheme, and the preliminary freeze would have to be vacated, after which the SEC could amend its complaint to state a claim directly

against Sanchou and freeze the account again as it sought relief.[32] Thus, the court assumed that Sanchou either had no legitimate claim to the funds or that he was a wrongdoer.

The problem with *Cherif* is the Seventh Circuit's willingness to have the lower court apply the relief defendant label to Sanchou, who may have been — rather than an innocent party with no claim to the funds — an investor or an employee with an ownership interest in the funds in his brokerage account. He could have both had a legitimate claim to the funds *and* been innocent. That is, Sanchou may have had an innocent agreement with Cherif to receive a portion of the trading proceeds in return for Cherif's use of Sanchou's name and his account — or he may have had a similar agreement to receive a salary in return for the service he was providing Cherif. Thus, Sanchou could have been an investor, an employee, or something between the two. The court, however, did not attempt to resolve this problem and thus left the relief defendant concept open to interpretation. The Seventh Circuit's willingness to instruct the district court to add Sanchou as a nominal defendant without analyzing whether he had a legitimate claim to the funds made *Cherif* a ripe candidate for both attackers and defenders of innocent investors and employees in financial frauds.

Consequently, after *Cherif*, the relief defendant concept received further analysis, but what constituted a legitimate claim remained, and still remains, vague. Courts thus far addressing the issue agree on one thing: the definition of a relief defendant is a party against whom no wrongdoing is alleged but who holds receivership funds to which she has no legitimate claim or ownership interest.[33] Thus, courts agree that relief defendants can only avoid disgorgement by summary judgment by showing a legitimate claim or ownership interest in the funds they hold.[34] However, despite these basic agreements, interpretations still conflict. As shown below, the entire controversy revolves around the meaning of "legitimate claim or ownership interest." If courts bend the meaning of these plain words, they can — and have — come to diverse and, importantly, unpredictable outcomes. Settling this meaning will mean less confusion, less litigation, less money in the receiver's pocket and more in investors' hands.

DEFINING "LEGITIMATE CLAIM OR OWNERSHIP INTEREST" FOR INVESTORS AND EMPLOYEES

Cherif, in addition to the flexible nature of equity decisions,[35] kept the door open for divergent views on how investors and employees should be treated when added as relief defendants. Some courts, such as the Sixth Circuit in *SEC v. George*,[36] have inappropriately found that investors do not have a legitimate claim or ownership interest in, at a minimum, the amount of their principal investment.[37] Other courts, acknowledging the plain meaning of "legitimate claim or ownership interest," protect, at minimum, investors' principal.[38]

Likewise, some courts addressing employees as relief defendants summarily, and improperly, order disgorgement of the employees' funds even though, as relief defendants, no wrongdoing is alleged against them. Other courts recognize that innocent employees have acquired a legitimate claim by providing services in return for compensation.[39] The uncertainty for investors and employees added as relief defendants in investment frauds needs to be leveled by more authority in favor of the clear meaning of "legitimate claim or ownership interest." The cost stemming from such uncertainty, as shown below, can be devastating to relief defendants.

Investors as Relief Defendants

The most important case holding that investor relief defendants are subject to summary disgorgement of both principal and interest is *SEC v. George*.[40] There, Steven Thorn, Derrick McKinney, and Rick Malizia solicited 550 investors for what they advertised as secretive "European fixed-instrument securities, including medium term notes."[41] The investors were told that their investment would be pooled with others' to reach threshold levels for preferred rates of return. In reality, no investment occurred and Thorn, McKinney, and Malizia pooled the money to pay monthly "returns" to investors and make lavish personal purchases for themselves.[42] In short, it was a Ponzi scheme.

In addition to claims against Thorn, McKinney, and Malizia, the receiver sought summary judgment — in the form of clawbacks — against investor relief defendants.[43] The receiver pursued investors for principal,

"interest" earned on the investments, and prejudgment interest in an attempt to gather receivership funds and distribute them on a pro-rata basis. The Southern District of Ohio agreed with the receiver that, even though no wrongdoing was alleged against them, the investor relief defendants had (1) obtained receivership funds to which (2) they had no legitimate claim. The court granted summary judgment to the SEC.[44] Four of these relief defendants — Durietha Dziorney, Carl Jackson, Frederick Harris and Allen George — argued that they had a legitimate claim to the funds they received from the scheme.

Dziorney was Thorn's fiancée during the scheme, but she, rather than investing, simply received nearly $100,000 in cash and gifts (including a $66,000 engagement ring) from Thorn's pool of investor money;[45] her arguments of legitimate claim were rightly rejected and the district court ordered her to disgorge the funds.[46] Jackson, Harris, and George were each innocent investors, against whom no wrongdoing or complicity was alleged, whose investment proceeds (plus prejudgment interest) were clawed back. Jackson had invested $285,000 in the notes and received only $282,320 back. Although he was a "net loser," the district court ordered him to disgorge the full $282,320 plus $70,721 in prejudgment interest.[47] Harris, also a net loser, had invested $1,186,000 and received only $505,920 in return; the district court ordered him to disgorge the full $505,920 plus $139,867 in prejudgment interest.[48] Finally, George, a net winner, had invested $37,000 and received $79,300 in return; the district court ordered him to disgorge the $79,300 plus $13,495 in prejudgment interest.[49]

On appeal to the Sixth Circuit, the question for all four relief defendants was whether they had established a legitimate claim to the funds.[50] No court has held that a gift gives rise to a legitimate claim, and Dzironey was properly made to disgorge her gifts. However, the Sixth Circuit was incorrect as to the three investor relief defendants. To order the three innocent investors to disgorge everything related to the investment scheme, plus prejudgment interest, the court had to ignore the plain meaning of "legitimate claim or ownership interest," the definition of which must include contractual returns on debt.[51]

After giving token recognition to the standard relief defendant definition by quoting *Cherif* and other cases, the Sixth Circuit stated that, "Each

of the relief defendants in this instance received ill-gotten funds and had no legitimate claim to those funds."[52] The court then said, "Jackson, Harris and George [ ] received ill-gotten funds from the defendants. While each of the three invested his own money in Thorn's investment scheme, the SEC showed that the money they received from the scheme came *not from profits on their investments but from the investments of others*."[53] This focus on tracing scrambled the plain meaning of "legitimate claim."

Tracing one's profits to one's principal has never been necessary to establish ownership over investment proceeds, and such a requirement is unforeseen and onerous from an investor's view. Yet tracing was the only method, in the Sixth Circuit's eyes, by which the investors could have established a legitimate claim:[54] "[Jackson, Harris, and George] failed to come forward with any evidence rebutting the SEC's tracing evidence. To survive summary judgment in the face of the SEC's evidence, the relief defendants needed to present affirmative evidence, not just affirmative assertions, demonstrating a disputed issue of material fact. They did not do so."[55] Thus, the investors — two of whom received less than their principal investment — had to disgorge every penny, plus interest, that they had received according to contractual agreement, even though no wrongdoing was alleged against them. Thus, the court suggested that an investor may not have a legitimate claim to the amount of his own investment and that, even in the absence of wrongdoing, an investor can only prove a legitimate claim by tracing the dollars he received from the scheme to the dollars he placed into the scheme.

This obvious misuse of the relief defendant tool came in the misguided pursuit of equity. The Sixth Circuit, like the district court, wanted every creditor to receive 42 percent of their principal in accordance with the receiver's distribution plan.[56] Indeed, the court mandated total disgorgement even though it knew that Thorn had told potential investors before they invested that their money would be pooled with that of other investors in order to reach optimal, threshold levels of investment.[57] Thus, investors knew from the outset — and the court knew before writing its opinion — that the money would be pooled and would not be traceable by investors. The court used traceability as the only factor determining whether an investor had a legitimate claim even though it knew that not a single investor could avoid disgorgement by tracing payout to principal. Thus, against plain meaning,

the court turned the expansive "legitimate claim or ownership interest" evaluation into a single-prong test for tracing. This move has helped keep the meaning of legitimate claim or ownership interest cloudy.

Protecting Investors

Investor relief defendants should be protected by courts' recognition that innocent investors have a per se legitimate claim to their investment proceeds — at a minimum, the amount of principal invested. Probably the most important counterweight to *George*'s authority on this issue is *Janvey v. Adams*, which is addressed below. However, other courts have also adhered to the plain meaning of "legitimate claim or ownership interest," finding that investors have a legitimate claim to funds stemming from their investments. For example, in *FTC v. Direct Mktg. Concepts, Inc.*,[58] the court held that Lisa Mount, an investor and former employee of one of the companies in receivership, had to be protected from disgorgement. The corporation, which was allegedly used as part of a fraudulent infomercial scheme, made distributions to Mount, but there was no evidence that the distribution was anything but a legitimate return on her investment in the corporation.[59] Thus, the funds could not be disgorged since there was significant doubt regarding the nature of the distribution. In this instance, the court properly recognized that, since there was a strong possibility that the distribution was not just a gift or siphoning of funds, Mount, as an investor, should be protected.

Other courts have similarly held, even in the context of full defendants against whom causes of action are asserted, that otherwise innocent investors have a claim to investment funds.[60] For example, in *Johnson v. Studholme*, the receiver claimed, among other things, that the investors in a Ponzi scheme investigated by the CFTC had not given value for their returns on investment. The court disagreed, finding that the investors had given value for their entire returns:

> There was…no allegation that the defendants received these payments with anything less than a good faith belief that it was a legitimate return on their investment as part of a contractual relationship…. The plaintiffs' contention that the defendants were not purchasers for value is…wrong because the value given by the investors was, of course,

> their contributions and the risk that they may lose all or part of their investment…. While the scheme may have been illegal, from an economic perspective there is no doubt that the innocent investors gave value. They did all that was asked of them in the representations which induced their investment.[61]

In *Chosnek v. Rolley* the receiver attempted to claw back investors' returns on the theory of unjust enrichment, but the court protected investors' principal: "[A]n innocent investor in a Ponzi scheme is not unjustly enriched when he receives returns on his investment in good faith and while ignorant of the scheme, so long as the returns do not exceed the amount of the original investment. To the extent of the original investment, such are not subject to claims made by later investors on the theory of unjust enrichment."[62] Even though the theories against them are similar, the legitimate claim requirement should be more easily met for relief defendants than full defendants being pursued under unjust enrichment or fraudulent transfer claims, since relief defendants are usually defrauded already and they are not allowed full defensive protections. As the Eleventh Circuit noted, "It would be difficult for equity to permit the Receiver to bring money into the receivership from someone who was defrauded…. In effect, equity would be sanctioning further torment of a defrauded investor."[63]

Employees as Relief Defendants

To demonstrate the arguments made when receivers or agencies attempt to claw back funds from employees, *SEC v. Infinity Group*[64] and *SEC v. Amerifirst Funding*[65] are examined. As with the investor context, problems have arisen in the employee-as-relief-defendant context when courts do not recognize that workers have a legitimate claim to the compensation they earn in return for services.

SEC v. Infinity Group

In *Infinity Group*, the Eastern District of Pennsylvania started on the right foot: with the proper definition of a relief defendant.[66] However, it refused to acknowledge that the principal's wife, Susan Benson, had any

legitimate claim to the funds she held and presumably worked for.[67] To reach this point, the court recognized that Mrs. Benson may have worked for the funds, but stated that, "[T]o the extent Susan Benson earned any of the funds which were transferred into these trusts, she did so in the service of the very unlawful offering and sale of securities which is the subject of these proceedings. It would be contrary to the securities law to allow Mrs. Benson to launder the proceeds of a securities fraud by billing bilked investors for services rendered in furtherance of that fraud. Illegal consideration is invalid consideration and thus cannot shield ill-gotten gains from disgorgement."[68]

Although the court likely arrived at the correct outcome (Mrs. Benson probably was a wrongdoer or co-conspirator), it did so by misapplying its own definition of relief defendant in two ways: first, Mrs. Benson stated a legitimate claim to the funds; second, the court imputed wrongdoing to her. Either of these misapplications should be enough to place a party outside the relief defendant realm, and the *Infinity Group* court created enormous uncertainty by overlooking its two obvious missteps. If Mrs. Benson worked for the money, which the court seemed willing to accept, she had stated a legitimate claim. Further, there is no question that the court considered Mrs. Benson to be a wrongdoer — indeed, a launderer. However, a relief defendant is, by definition, accused of no wrongdoing. Since Mrs. Benson convinced the court that she *might* have worked for the funds, she should have been released as a relief defendant and pursued as a full defendant with full defensive rights, rather than being summarily deprived of her assets. The court overlooked a legitimate claim — which Mrs. Benson articulated — in favor of potential wrongdoing, thereby muddling the relief defendant concept and keeping the door wide open for suits against employees.

In addition to confusing a legitimate claim with wrongdoing, the *Infinity Group* court created an untenable standard for summary disgorgement: if a person has been "in the service of the very unlawful offering and sale of securities which is the subject of [the] proceedings," she has no legitimate claim to the funds she holds. Presumably, this broad definition could be applied to anyone who supports an unlawful offering, whether they know the offering is unlawful or not. Under this standard, everyone from

officers and directors to gardeners and janitors could be subject to summary disgorgement.

SEC v. Amerifirst Funding

In *Amerifirst Funding*, Jeffrey Bruteyn and others orchestrated an investment fraud through closely-held, affiliated corporations.[69] Hess Financial was one of these corporations, and it provided consulting services to Bruteyn's Amerifirst Group, which was in receivership. Hess was added as a relief defendant, with the SEC seeking to disgorge any money that Bruteyn had fraudulently obtained and then used to pay for consultations.[70] The district court for the Northern District of Texas issued a default judgment against Hess, and in the later disgorgement quantification order, the court explained its reason for complying with the SEC's wishes: "Because (1) the AmeriFirst entities paid Hess Financial with ill-gotten funds from investors who purchased the illegal SDOs [(self-directed investment options)] and (2) Hess Financial does not have a legitimate claim to these funds, Hess Financial should disgorge the 'consulting fees' it received from the AmeriFirst entities. Although Hess Financial might have had a legitimate claim to 'consulting fees' had it been unaware that its consulting services were furthering securities fraud, Hess Financial cannot invoke a good faith defense because its head, Bruteyn, was a principal actor in the securities fraud scheme."[71]

As with *Infinity Group*, the court almost undoubtedly arrived at the correct outcome — that is, since Bruteyn headed Hess, the corporation could be imbued with knowledge of the investment fraud. However, in arriving there, the court misapplied the relief defendant tool. The court recognized that the consulting services provided, and the fees charged, to Amerifirst could have been legitimate and reasonable.[72] Yet the court moved on to say that Hess was a knowing participant in the fraud, and that it could therefore not use a "good faith defense" — something reserved only for full defendants, as in a fraudulent transfer action where the defendant must prove not simply a legitimate claim but good faith and value.[73]

Wrongdoers cannot be relief defendants, as the court noted in its own definition: "[T]he SEC may seek disgorgement from 'nominal' or 'relief' defendants who are not themselves accused of wrongdoing in a securi-

ties enforcement action where those persons or entities (1) have received ill-gotten funds, and (2) do not have a legitimate claim to those funds."[74] Even though the court properly recognized this definition, it treated Hess as both a relief defendant and a wrongdoer — a move that is clearly incorrect and one that leads to confusion. If the court saw that Hess, knowing of Bruteyn's fraud, had rendered services for payment, it should have dismissed him as a relief defendant since he had a legitimate claim to the funds he held; the SEC could then have pursued Hess as a full defendant and wrongdoer. There are many doctrines under which Hess could have been pursued as a full defendant, including fraudulent transfer, unjust enrichment, or even violation of the securities laws. Instead, the court blended wrongdoing with the relief defendant tool. This blending keeps the door open for error and — the ultimate harbinger of economic wastefulness — uncertainty. Even if the court arrived at the correct result, it confused the relief defendant concept — inviting future litigation based on doubt that any particular relief defendant actually has a legitimate claim to the funds she holds.

Protecting Employees

Innocent employees have a legitimate claim to the funds distributed to them in return for their services. Although cases like *Infinity Group* and *Amerifirst* are establishing precedent against this proposition, others recognize this solid, predictable principle. More authority is needed to firmly establish it.

Ross is a very strong case for the plain meaning of "legitimate claim or ownership interest" for employees because it explicitly instructs regulatory agencies and receivers to avoid what likely was done in *Infinity Group* and *Amerifirst Funding*, viz. finding no legitimate claim because the relief defendant might be a wrongdoer.[75] In *Ross*, relief defendant Ernest Bustos, an ex-salesman of the entity in receivership (a company selling interests in payphones), appealed an order from the District of Oregon that he disgorge all of his commission payments.[76]

The Ninth Circuit first noted that summary proceedings against relief defendants — including low standards for service of process and establishing personal jurisdiction, and summary disgorgement if there is no

showing of a legitimate claim to the funds — were fair and helpful in marshaling the assets of a receivership, but only as long as those pursued fell cleanly into the definition of a relief defendant.[77] The court noted that Bustos clearly had a legitimate claim to the funds: "Bustos appears to be no different from any other employee or vendor: he received compensation in return for services rendered. As such, he has presumptive title to those commissions, and unless the Receiver can prove otherwise, it is likely that the Receiver can disgorge those commissions only by showing that Bustos has himself violated the securities laws."[78]

After establishing that Bustos was not a proper relief defendant because he had a legitimate claim to the funds, the court went on to reprove the receiver and the SEC for suggesting that Bustos should disgorge his commissions because he was a wrongdoer in the fraud.[79] Noting that the SEC had many options by which to pursue wrongdoers and that relief defendant disgorgement was not one of them in this instance, the court said, "However the Receiver or the SEC chooses to proceed, we admonish both to avoid improper shortcuts. Unless they can articulate some theory of liability that does not turn on Bustos's own violation of the securities laws, they must formally serve him with process, properly obtain *in personam* jurisdiction over him, permit him to litigate fully all issues relating to both the fact and scope of his liability, and do so, of course, subject to all available legal and equitable defenses."[80]

Thus, the court recognized that the SEC had violated two of the facets of the relief defendant definition: that a relief defendant has no legitimate claim to the funds and that a relief defendant is not a wrongdoer. The court did not, as others have done, mix the concepts of legitimate claim with wrongdoing, noting instead that a wrongdoer has the right to the due process and defensive mechanisms offered to all full, or primary, defendants.[81] Thus, *Ross* is a major piece of the firewall being built up against cases like *George*, *Infinity Group*, and *Amerifirst Funding*. By following the reasoning in *Ross*, other courts would not only recognize that employees have a legitimate claim to their remuneration, but also that such employees, if wrongdoers, have to be pursued as full defendants with the ability to defend themselves.

CFTC v. Walsh: A Template for Reasonably Deciding the Legitimate Claim Question in Any Context

General principles should apply whenever a court is deciding whether a relief defendant has a legitimate claim to the funds at issue. *CFTC v. Walsh* is among the best examples of a court's grappling with the plain meaning of "legitimate claim."[82] There, Ms. Schaberg, the wife of the supposed fraudster Walsh, was added as a relief defendant in a case by the SEC and CFTC against her husband and his business partner.[83] The funds and luxury items the SEC and CFTC sought from Schaberg were traceable to Walsh's misappropriation of his clients' funds, but Schaberg had acquired them in a divorce settlement agreement from Walsh some three years before the SEC and CFTC brought suit against him.[84] The question, therefore, was whether Schaberg had acquired a legitimate claim to the funds by signing the settlement agreement in which, she argued, she gave up legal claims against her husband in return for the assets.[85]

The court admitted that it had never constructed guidelines on what constitutes a legitimate claim or ownership interest.[86] Attempting to form a baseline, it accepted the notion that if Ms. Schaberg could establish that the foregoing of her legal claims was in good faith and valuable,[87] then her assets would be protected from disgorgement — at least until she was pursued under some other theory.[88]

Ultimately, the court had to certify questions to the New York Court of Appeals rather than solve them itself since, taking the relief defendant concept seriously rather than imputing Schaberg with wrongdoing or otherwise foregoing analysis, it recognized that the matters of value and property were state law questions for which it had no answer.[89] Even though the court did not reach a final resolution, this case is a prime illustration of how courts should conscientiously approach the legitimate claim question: first, the court set reasonable parameters, based on other cases, as to what could be considered a legitimate claim under the plain meaning of that term.[90] It recognized that, on one hand, gifts from a spouse — as in *George* — would not give rise to a legitimate claim while noting that, on the other hand, receiving compensation for services rendered to an employer or purchasing assets for value would give rise to such a claim. Second, after setting these parameters, the court did not avoid the meaning of a legitimate claim by

imputing wrongdoing to the relief defendant or order disgorgement simply because the regulatory authority sought it. Instead, it engaged in thoughtful and serious analysis of what, under law and clear meaning, constitutes a legitimate claim. Recognizing that it could not, even in equity, go further, it turned the questions over to the state court for help.[91]

As long as courts do not gloss over the meaning of "legitimate claim or ownership interest," they will likely either come to a reasonable conclusion that stems from the words themselves and the legal standards they represent (as in *Ross*), or reach a point at which they can go no further (as in *Walsh*). In the context of relief defendant employees and investors in fraudulent schemes, however, the way forward is clear in, almost certainly, every case: courts should find that remuneration and principal invested give rise to a legitimate claim. If the parties then can be sued as full defendants under fraudulent transfer, unjust enrichment, or fraud claims, then so be it, but a party holding remuneration for services or investment principal cannot be a proper relief defendant. There can be no other reasonable reading of the agreed-upon language.

SEC V. STANFORD INTERNATIONAL BANK: AN ILLUSTRATION OF THE LEGITIMATE CLAIM CONFUSION AND ITS COSTS

Receivers, who are officers of the court appointing them, exist to benefit investors and other creditors.[92] Yet when receivers (or regulatory agencies, who are often the named plaintiffs in such suits) ignore the plain meaning of "legitimate claim or ownership interest" to pursue investors' principal or employees' remuneration by adding these parties as relief defendants, problems arise. If the receiver loses, he hurts creditors of the current receivership through misguided and wasteful litigation; if he wins, he hurts creditors of future receiverships by creating or perpetuating uncertain definitions. In litigation stemming from *SEC v. Stanford International Bank*,[93] the receiver — relying on flawed precedent such as *George* — was ultimately prohibited from seeking disgorgement from investors as relief defendants. This prohibition indicated to him that he would not prevail on relief defendant claims against employees, so he dropped those as well. The case presents a perfect opportunity to illustrate the conse-

quences, both in terms of legal arguments and practical, economic costs, of the uncertainty created by cases like *George*.

Background and Law in *Janvey v. Adams*

The Department of Justice, through a grand jury, indicted R. Allen Stanford (the sole shareholder and chairman of Stanford Financial Group, including Stanford International Bank) and his closest confidants and officers in June 2009 for violations of securities laws by running a massive Ponzi scheme.[94] Ralph Janvey, the SEC-picked equity receiver of Stanford Group Company (a Houston-based broker-dealer subsidiary of Stanford Financial Group with its own subsidiary corporations)[95] was appointed by the Northern District of Texas in February 2009. The court directed him to recover traceable receivership assets for the benefit of investors and other creditors.[96] Janvey immediately froze investors' and employees' brokerage accounts and funds traceable to Stanford Financial Group in other places.[97] He then fired the employees.[98]

Although the *SEC v. Stanford* family of cases (both the SEC and ancillary suits) is large and growing, *Janvey v. Adams* is the most important relief defendant battle of the group — and possibly the most important relief defendant case since *George*. There, the receiver, in an action ancillary to the SEC suit, attempted to claw back investor relief defendants' principal and employee relief defendants' compensation before the Northern District of Texas and, on appeal, before the Fifth Circuit.[99] Only the issue of investor relief defendants was reached by the Fifth Circuit, although much of the same reasoning would apply to employee relief defendants, as Janvey recognized when, after the Fifth Circuit's decision, he released the employees and re-added them as full defendants to be pursued under unjust enrichment and fraudulent transfer ("UFTA") claims.[100]

The receiver's freeze, which began in February 2009, ultimately encompassed some 32,000 accounts.[101] After a few months, Judge Godbey of the Northern District of Texas recognized the freeze's hardship on account holders, and ordered that the receiver either assert claims against holders or release their accounts by early August 2009.[102] To keep their accounts frozen and hopefully claw back investment proceeds and remuneration, Janvey added as relief defendants hundreds of certificate of de-

posit ("CD") investors and ex-Stanford employees who had sold those CDs.[103] In his complaints against them, the receiver sought not only the investors' interest, but also their principal invested (even from numerous "net losers," or those who received less in investment proceeds than they had invested in principal); from ex-financial advisors he sought base pay, commissions, bonuses, and employee-forgivable loans.[104] He rested his complaints on the notion that the investors and former employees had no legitimate claim to any of these funds because they were simply lucky, not meritorious, to have received payments from other investors' and creditors funds before the scheme crashed down.[105] The court-appointed independent examiner and the SEC itself quickly set themselves in opposition to Janvey's attempts to disgorge so much from these already-harmed parties against whom no wrongdoing had been alleged. In fact, the SEC even requested that the receiver's order be modified to disallow the receiver from pursuing clawbacks for investor's principal.[106] Despite firm opposition, Janvey plowed forward.[107]

Under a firestorm of arguments against Janvey's continued freeze and questionable pursuit of relief defendants, the district court held a hearing on July 31, 2009, in which the receiver, representatives of the relief defendants, the examiner, and the SEC all participated.[108] The hearing's main issue was the receiver's motion to continue a freeze on hundreds of investor and employee relief defendants — including a freeze on many investors' principal amounts received from Stanford. During the hearing, all parties (except the receiver) spoke against Janvey's freeze on the investors' principal, and argued that such funds should be released immediately. The SEC vociferously objected to Janvey's actions, and Janvey himself stated that he had angered the SEC to such an extent by pursuing investors' principal that he was certain never to be chosen as a federal equity receiver by the Commission again.[109] When Judge Godbey issued his order, there were few surprises: he allowed the freeze to continue as to investors' interest and he ordered release of investors' principal amounts, but he stayed the release until August 13, 2009, to give the receiver an opportunity to seek from the Fifth Circuit an extension of the freeze pending appeal.[110] Janvey received the extension,[111] and the Fifth Circuit heard oral arguments on November 2.[112]

At the hearing, the receiver based his argument — that he should be allowed to seek complete disgorgement from investors as relief defendants for the purpose of an ultimate, pro rata distribution — on only two cases: *George* and *CFTC v. Kimberlynn Creek Ranch*.[113] The court found neither of these cases helpful to the receiver and instead construed them to support its ultimate holding that Janvey could not pursue investors as relief defendants at all.[114] Indeed, the court actually determined that investors have a legitimate claim to *all* of their contractual investment proceeds — both principal and interest.[115]

> [T]he Receiver has failed to establish that the Investor Defendants lack a legitimate claim to the CD proceeds they received from the Stanford Bank. They are therefore not proper relief defendants…. It is undisputed that the Investor Defendants received the CD proceeds pursuant to written certificate of deposit agreements with the Stanford Bank, which granted them certain rights and obligations. There was a debtor-creditor relationship between the Investor Defendants and the Stanford Bank based on written agreements well before the underlying SEC enforcement action against Stanford and the resulting receivership and restraining order. This constitutes a sufficient legitimate ownership interest to preclude treating the Investor Defendants as relief defendants…. Therefore, the Receiver's claims and motions as to the Investor Defendants [regarding both principal and interest] should have been denied completely.[116]

The court found a legitimate claim in the debtor-creditor relationship, while quoting *Kimberlynn Creek Ranch* itself for another example: "[R]eceipt of funds as payment for services rendered to an employer constitutes one type of ownership interest and would preclude proceeding against the holder of the funds as a nominal defendant."[117]

No weight was given to whether payments to investors were traceable to each investor's contribution. In fact, interest from a Ponzi scheme can never come from one's own investment. Despite the obvious conflict with the Sixth Circuit's definition of legitimate claim in *George*, which equated the term with tracing, the *Adams* court recognized no discrepancy between the two cases. It cited *George* as being consistent with its own holding —

but only for the nominal definition of relief defendants as parties with no legitimate claim to the funds they hold, not for the interpretation of "legitimate claim."[118] It is at that point that *George* and *Adams* diverge. The two cases (and nearly all other relief defendant cases) recognize the definition of a relief defendant, but they differ markedly in what constitutes a legitimate claim.

Commentators soon after *Adams* noted that the window of confusion had been left open.[119] Still, the case is strong persuasive authority for the treatment of relief defendants in the future. With any luck, courts will begin consistently recognizing that the relief defendant definition does not allow for recovery of investors' principal (as held in *Adams*) or employees' remuneration (as Janvey recognized soon after the Fifth Circuit decision when he released the financial advisors as relief defendants).

The Practical, Economic Cost of Confusion

Janvey's improper pursuit of relief defendants' principal, though ultimately unsuccessful, produced four hardships for creditors, most of whom were investors in the CD: first, it extended the litigation period for investors and financial advisors, placing a burden on them to stay engaged and pay attorneys' fees; second, the freeze denied hundreds of investors access to their accounts for many months, thus imposing opportunity costs on account holders; third, the pursuit delayed ultimate relief for *all* creditors; fourth, by draining receivership funds and directing them to the receiver's pocket, it decreased the amount that creditors could be paid back. Inherent to these hardships is a conflict of interest for receivers: their job is to capture as much of the receivership estate as possible for distribution to investors, but they know that the more litigation they spawn, the longer they will be paid out of the receivership itself. Thus, in their zeal to recoup receivership assets, it may be easy for receivers to overlook the fact that, "To undo all of these transactions would cause incalculable harm to hundreds of people, at a staggering cost, for which no commensurate benefit would lie."[120] The purpose in illustrating these four issues is to give an idea of how much time and money could be saved in a case like *Adams* if receivers and courts adhered to the plain meaning of "legitimate claim or ownership interest."

The First Problem: Extended Litigation

Extended, unnecessary litigation is an enormous financial hardship for investors who have already been defrauded. This financial hardship occurs in at least two forms: opportunity cost for time spent on one's own defense, and direct cost paid to one's attorney.

For months, Janvey and his team chased relief defendants who turned out to be improperly pursued. These months represent lost time for the relief defendants as well as lost money flowing to their defense attorneys. That is, investors not only lost promised proceeds from their investment; they also lost legal fees. This problem is especially acute with regard to net losers. These people are by definition already harmed by the fraud and should not be defending themselves at all unless they are wrongdoers themselves. Just as the Sixth Circuit should have recognized of Jackson and Harris in *George*, the net losers in *Adams* had a legitimate claim to what little amount was held in their accounts; they should not have been drained of even more money by paying attorneys' fees and losing work hours while defending against the receiver's attacks. But litigation was needlessly extended even for net winners and employees in the Stanford case — for many, from April until November 2009.

Although no data exist to precisely quantify these losses, according to the Examiner, Janvey was pursuing 913 relief defendants (investors and employees) when the Fifth Circuit ruled against him on November 13, 2009.[121] Since many relief defendants found relatively low fees by joining a group headed by one attorney,[122] a mean low of $1,000 and a mean high of $2,000 per relief defendant is a very conservative but plausible estimate for the legal work undertaken for months on their behalf. As for opportunity cost, this article conservatively estimates a mean low of 30 working hours lost (almost two hours per week for those pursued from late July to November 13)[123] and a mean high of 40 working hours lost (approximately two-and-a-half hours per week), at a low estimated mean rate of $40 per hour and a high mean of $50 per hour. This is in view of the fact that most relief defendants were officially pursued as such from July 28 to November 13 — even though the brokerage accounts of most added as relief defendants on July 28 had been frozen since February and they had been consulting with their attorneys well before being added to the

suit. Using these very conservative numbers, it is estimated that the relief defendants lost between $913,000 and $1,826,000 in attorneys' fees, and between $1,095,600 and $1,826,000 in opportunity cost, for a total loss of $2,008,600–$3,652,000.

These rough estimates demonstrate the cost, however well-meaning, imposed by the receiver on those he was meant to serve. Of course, the fact that the receiver was seeking considerably more from relief defendants for pro rata distribution than the few million dollars his actions directly cost them shows that his approach was not completely devoid of cost-benefit analysis.[124] The point is that an understanding of the plain definition "relief defendant" likely would have saved investors and employees millions of dollars in attorneys' fees and opportunity cost alone. That is, if Janvey could not have so easily molded the relief defendant concept into a *George*-esque argument, he probably would not have taken that losing stance in the first place.

The Second Problem: Account Freezes

In an account freeze that often accompanies an SEC investigation, those with frozen accounts lose two sources of value: first, they cannot, as they would normally, use their accounts to participate in the investments of their choosing because the funds in the account remain in indefinite limbo; second, since the funds cannot be invested, investors cannot use the funds themselves or lost investment proceeds for wealth accumulation or living expenses — indeed, some people (imprudently, perhaps) live day to day on their brokerage accounts and investment proceeds and are financially crippled by a freeze.[125]

In February 2009, the court initially froze about 32,000 brokerage accounts with possible connections to the certificate of deposit, representing approximately $6 billion in assets; since one of the Stanford entities — Stanford Group Company, the Houston-based umbrella entity for which Janvey was receiver — was a registered broker-dealer, many of the accounts were trading accounts that had nothing to do with the CD under investigation.[126] Thus, after sorting them, Janvey began requesting release of mutual fund accounts as well as those under $250,000 not tied to the apparent fraud.[127] Later, Janvey requested release of thousands more accounts with no funds

traceable to the CD proceeds.[128] Finally, the court set a deadline, saying that all frozen accounts must either be connected to a complaint or released by August 3, 2009.[129] On July 28, 2009, Janvey issued a list of 563 investors and financial advisors with frozen accounts that he was adding as relief defendants.[130] These investors represented a combined total frozen of $373,000,093.[131] When the Fifth Circuit told Janvey that he could not pursue investors as relief defendants, it also told him that all investor accounts had to be unfrozen.[132] Thus, on November 13, 2009, all accounts — except employee brokerage accounts — were available for release.[133]

Conservatively then, the unnecessary freeze was of $373,000,093 in investor relief defendants' accounts, which extended from July 28 to November 13, 2009. The 563 investors with frozen funds were harmed financially during the 16 weeks of improper freezing. Although this article does not attempt the incredibly complicated task of quantifying the harm stemming from investors' inability to access or reinvest their money, receive regular payments from their investments, or regularly draw on their accounts to live, the damage is undoubtedly substantial.

The Third Problem: Delay of Ultimate Distribution

Investors, particularly debtholders, expect to have access to their investment proceeds. Of course, in a Ponzi scheme investigation or other case of investment fraud, investors will necessarily have to wait for regulators, the receiver, and the supervising court to work things out. However, when a receiver extends litigation by spending months seeking receivership funds from unfruitful sources, investors are kept unnecessarily from the ultimate distribution of the receivership for longer than necessary, thereby increasing investors' economic loss by taxing the time value of their money.

Janvey caused delay in the ultimate distribution of the receivership by pursuing investors' principal and employees' remuneration in the relief defendant context. Since there will be no final distribution (although there may be some interim distributions) until the receiver has completed his work of garnering receivership assets, this delay was imposed on all Stanford Financial Group creditors, even those who were not relief defendants. When the dust finally settles, investors who did not happen to receive CD payments can only hope to receive a few pennies on the dollar,[134] but hav-

ing to wait extra months because the receiver is chasing improperly-added relief defendants adds insult to injury and again implicates the time value of money. However, since the size and timing of the ultimate distribution are so uncertain, the time value of the distribution is also uncertain. When the numbers are known, the time value of the extra months spent trying to fruitlessly claw back investors' principal will be considerable, regardless of the multiplier used.

The Fourth Problem: Depletion of the Receivership Estate

Receivers are paid out of the very receivership they are trying to protect and enlarge. Thus, the longer a receiver files claims, the longer he and his team of attorneys, accountants, and others are paid; however, the more the receiver is paid, the less is available for final distribution to creditors.

By April 2010, Janvey had asked for a total of $53,330,000 in fees and expenses for him and his team. Nonetheless, receivers, as officers of the court, must have their fees approved by the court, and the court can adjust the receiver's payment for services. Although each jurisdiction may have slightly different factors for deciding how much of a receivers' fees to pay,[135] in this instance the Northern District of Texas was governed by the "*Johnson* factors."[136] One of these factors is the "amount involved and the results obtained," which gives some discretion to the court to discount a receiver's application if the fee application is large compared to the amount available for distribution or if the receiver's pursuit of funds is inappropriate.[137] Using this and other factors, the court temporarily discounted all of Janvey's fee applications by 20 percent, inviting him to reapply for the hold-back amount when the size of the recovered receivership became clearer.[138]

In addition to the court's 20 percent general discount, the court applied, partially accepting the argument of the SEC and the examiner,[139] an additional 15 percent temporary discount to fees requested from June to November 2009, the period during which the receiver improperly pursued relief defendants. This extra discount reflected the lack of "results obtained" during the period, and showed the court's tempered concern that a receiver should not be rewarded for charging down unfruitful paths. However, despite the 35 percent total discount for that five-month period, the receiver and his team still received over eight million dollars of receiver-

ship funds, and the lost 15 percent, like the general 20 percent discount, is potentially recoverable.

Thus, from the beginning of the receivership to the present, the receiver has been rewarded handsomely from receivership funds. In fact, at one point, Janvey had asked for approximately 34 percent of everything he had recovered from the estimated $8 billion scheme.[140] Further, of the $53,330,000 requested from February 2009 until April 2010, he has to date been awarded about $41,820,000 — approximately 78.42 percent of the bill, which he claimed to be already cut by 20 percent *before* the court imposed its own 20 percent discount.[141]

A receiver's worth must be tied in part to the difference between the amount he gathers for distribution and the amount of the receivership estate that he burns through. In Janvey's case, this ratio does not seem to be very high — much to the chagrin of investors, who are projected to receive very little. For relief defendants, where a receiver successfully pursues innocent investors' funds for redistribution to other innocent investors, the best that can happen is that, if successful in his clawbacks, the receiver gets paid some of the money coming in while the leftover wealth gets redistributed. Of course, as against net winners in a Ponzi scheme, there is a strong equitable argument in favor of this redistribution because anything beyond their principal comes from other investors, but this argument loses what appeal it has when applied to investors who received less than what they put into the scheme.[142] If the relief defendant concept were clear, it is conceivable that the millions of dollars paid to Janvey and his team for their improper pursuit of relief defendants would have remained in the pockets of investors instead.

Thus, Janvey and his team, relying on a poor but available interpretation of the relief defendant tool, hurt investors by improperly engaging innocent and already-harmed parties in litigation, preventing these innocent parties from accessing their accounts, delaying ultimate distribution, and shrinking that distribution by burning receivership funds unnecessarily.

CONCLUSION

The meaning of a "legitimate claim or ownership interest" must be reinforced, particularly when obvious clawback targets are involved, such as

investors and employees of fraudulent schemes. With cases like *George*, *Infinity Group*, and *Amerifirst Funding* placing the plain meaning into confusion, other courts should take every opportunity to settle the definition on its unambiguous foundation, thereby promoting judicial and economic efficiency.

Virtually every case addressing them uses the same definition to describe relief defendants, but the meaning of one part of that definition (what constitutes a legitimate claim) still varies widely — even though words are clear on their face. This unpredictability leads to innocent investors and employees, often already harmed by fraud, being further drained by costly litigation and clawbacks. In *Adams*, investors' and employees' accounts were frozen for months while litigation, based on uncertainty of the plain meaning, dragged on, costing millions of dollars in fees and opportunity cost. These scenes, which have been repeated in other Ponzi scheme and financial fraud receiverships, will continue to play themselves out — with funds being drained from investors and flowing toward receivers — until courts calm the uncertainty by predictably interpreting the meaning of "relief defendant." Of course, in cases of contractual relationships between the entity in receivership and debt holders, the proper course of action will be, as it was in *Adams*, to recognize a legitimate claim to both principal and interest amounts under the contract; as a baseline, however, courts should recognize that investors have a legitimate claim to their principal and that employees have a legitimate claim to their reasonable remuneration.

NOTES

[1] Amended Order Appointing Receiver, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. March 12, 2009); *See, e.g.*, Erik Larson, *Stanford Receiver May Need Decade to Pay Victims*, Bloomberg (Feb. 20, 2009) http://www.bloomberg.com/apps/news?pid=newsarchive&sid=adE7U5dJ7I_I.

[2] *See, e.g.*, Kristen Hays & Mary Flood, *Stanford Investors Get Access to Information but not Access to Cash*, Houston Chron., Feb. 20, 2009, available at http://www.chron.com/disp/story.mpl/business/stanford/ 6273878.html.

[3] *See generally* Kristen Hays, *Receiver in Stanford Case Catching Flak*, Houston Chron., March 22, 2009, available at http://www.chron.com/disp/story.mpl/business/stanford/6328631.html ("[Janvey's] team includes two law

firms — Baker Botts and Thompson & Knight — plus a business restructuring advisor, a forensic accounting and information technology expert, a brokerage specialist, a security consultant and a public relations firm."). *See also* Receiver's Motion for Approval of Interim Fee Application and Procedures for Future Compensation of Fees and Expenses and Brief in Support, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N, (N.D. Tex. May 15, 2009) (detailing receivership expenses from Krage & Janvey, L.L.P.; Baker Botts L.L.P.; Thompson & Knight LLP; FTI Forensic and Litigation Consulting; Ernst & Young; Financial Industry Technical Services, Inc.; Strategic Capital Corporation; Pierpont Communications, Inc.; 3-4 South Square; Roberts & Co.; Altenburger; Osler, Hoskin & Harcourt LLP; Liskow & Lewis; and Dudley, Topper and Feuerzeig, LLP).

[4] Receiver's Complaint Naming Stanford Financial Group Advisors as Relief Defendants at 27–28, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. April 15, 2009).

[5] *See generally* Clifford Krauss, *1,000 Stanford Financial Workers Dismissed to Save Company Assets*, NY Times, March 6, 2009, available at http://www.nytimes.com/2009/03/07/business/07stanford.html ("[Janvey] notified 1,000 employees of the Stanford Financial Group on Friday that their jobs were terminated in an effort to preserve the value of whatever resources were left in the company.").

[6] *See* Section IA, *infra*. *Accord SEC v. Colello*, 139 F.3d 674, 677–78 (9th Cir. 1998) (noting with approval the lower court's requirement that where a relief defendant was added, that party had the burden of proving a legitimate claim to the funds in question; if no such claim could be asserted, the funds would be disgorged by summary judgment).

[7] Although it does not involve relief defendants, a similar scene is playing itself out in the Madoff cleanup, with trustee Irving Picard bringing suit against investors who received more than they invested. *See, e.g.*, Michael Rothfeld, *Madoff Investors Brace for Lawsuits*, Wall St. J., July 26, 2010, available at http://online.wsj.com/article/SB10001424052748704719104575389141620473502.html.

[8] This article assumes that receivers generally have the power to pursue relief defendants, even though they do not represent the SEC but instead stand in the shoes of the entities in receivership. For a discussion of the argument, including authority, that receivers cannot sue investors of the entities in receivership, *see* Brief of the Securities and Exchange Commission, Amicus

Curiae, in Support of Appellees at 19–21, *Janvey v. Adams*, No. 09-10761 (5th Cir. Oct. 8, 2009).

[9] Some investors, like those in *Janvey v. Adams*, clearly have a legitimate claim under contract to both the amount of their principal and any interest they receive under fixed agreement. Other investors, perhaps equity investors subject to risks and who receive dividends or other payments out of corporate surplus and whose fortune rises and falls with the success of the entity in which they have invested, might reasonably be seen to have no legitimate claim to false dividends or interest.

[10] *See, e.g.*, *Scholes v. Lehmann*, 56 F.3d 750, 753–54 (7th Cir. 1995) (explaining that receivers and trustees are often given similar powers).

[11] Although state courts often appoint receivers, many securities fraud receiverships are initiated at the request of the SEC or other agencies in a federal enforcement action. The focus is mainly on these federal equity receiverships, in which receivers are appointed by the United States district court handling the enforcement matter.

[12] *S.E.C. v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992) (citing *SEC v. Safety Finance Service*, *Inc*., 674 F.2d 368, 372 (5th Cir.1982); *SEC v. Lincoln Thrift Ass'n*, 577 F.2d 600, 609 (9th Cir.1978); *SEC v. United Financial Group, Inc*., 474 F.2d 354, 358 (9th Cir.1973)).

[13] Another type of receiver, known as a statutory receiver, follows the guidelines set forth in the statute under which she is appointed rather than the court's appointment order. *See, e.g.*, *Kenworthy v. Hargrove*, 855 F. Supp. 101 n.4 (E.D. Penn. 1994) (secretary of banking became receiver of bank under Pennsylvania banking statute, which also specified her authority).

[14] *See, e.g.,* Order Appointing Receiver, *SEC v. Lauer*, No. 03-80612-CIV-ZLOCH (S.D. Fla. July 10, 2003); Order Appointing a Receiver, Freezing Defendants' Assets, and Ordering Other Ancillary Relief, *SEC v. Global Online Direct, Inc*., No. 1:07-CV-0767-WSD (N.D. Ga. June 4, 2007); Amended Order Appointing Receiver, *supra* note 1.

[15] Black's Law Dictionary (9th ed. 2009), nominal party.

[16] *See, e.g.*, *SEC v. Ross*, 504 F.3d 1130, 1142 (9th Cir. 2007) ("We do not believe that the Constitution permits the Receiver to use the nominal defendant designation to deprive one whose only plausible basis for liability is a violation of the securities laws of either his *right to full and formal service of process* or his right to *fully litigate the question of his own liability* under the securities laws.") (emphasis added).

[17] *Id.*
[18] *Janvey v. Adams*, 588 F.3d 831, 834 (5th Cir. 2009) (internal citations omitted).
[19] For a general discussion on summary proceedings in Ponzi scheme receiverships, *see S.E.C. v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992) ("Rule 56 of the Federal Rules of Civil Procedure gives the district court summary jurisdiction over all the receivership proceedings and allows the district court to disregard the Federal Rules." Claimants claiming prejudice by summary proceedings have the burden of proving it. In Elliott, investors who were summarily disgorged of their proceeds were denied procedural due process because they had no opportunity to rebut the receiver's claims); *see also S.E.C. v. Antar*, 120 F. Supp. 2d 431, 433 (D.N.J. 2000), *aff'd*, 44 F. App'x. 548 (3d Cir. 2002) (rejecting relief defendants' pleas for more discovery and disgorging the relief defendants of the funds in question).
[20] *See, e.g.*, *Adams*, 588 F.3d at 834 (there is no need for a relief defendant to demonstrate the full bundle of rights; much less is required to show a legitimate claim or ownership interest) (*citing Kimberlynn Creek Ranch*, 276 F.3d at 191; *SEC v. Cherif*, 933 F.2d 403, 414 (7th Cir. 1991); *SEC v. Founding Partners Capital Mgmt*., 639 F. Supp. 2d 1291, 1294 (M.D. Fla. 2009). Of course, even after being released as relief defendants and added as full defendants, the parties may be subject in some jurisdictions to common law or statutory claims that might claw back both principal and interest. *See SEC v. Credit Bancorp, Ltd*., 290 F.3d 80, 88–89 (2d Cir. 2002) (citing cases); *In re Burton Wiand Receivership Cases Pending in the Tampa Div. of the Middle Dist. of Fla*., No. 8:05-CV-1856T27MSS, 2008 WL 818504 (M.D. Fla. Mar. 26, 2008) reconsideration denied, No. 8:05-CV-1856T27MSS, 2008 WL 1986182 (M.D. Fla. May 6, 2008) (holding that full defendant investors could be sued by the receiver under the theories of unjust enrichment and fraudulent transfer); *cf. Donell v. Kowell*, 533 F.3d 762, 777 (9th Cir. 2008) *cert. denied*, 129 S. Ct. 640, 172 L. Ed. 2d 612 (U.S. 2008); *Scholes v. Lehmann*, 56 F.3d 750, 758 (7th Cir. 1995) (protecting defendant investors' principal). However, some cases use relief defendants in very odd ways. For example, in *Antar*, 120 F. Supp. 2d at 443, the court allowed the SEC to disgorge funds from relief defendants through summary judgment — using the Uniform Fraudulent Transfer Act against them, which is a cause of action that should be reserved only for defendants who have full procedural and jurisdictional rights. *See SEC v. Ross*, 504 F.3d 1130, 1142 (9th Cir. 2007) (holding that the SEC must

serve , obtain jurisdiction over, and give full procedures to, a party in order to bring an unjust enrichment cause of action against him, since his legitimate claim prevented him from being a relief defendant).

[21] Black's Law Dictionary (9th ed. 2009), claim; legitimate.

[22] *Id.*, interest.

[23] *See, e.g.*, *Bacon v. Rives*, 106 U.S. 99, 104, 1 S.Ct. 3, 6, 27 L.Ed. 69 (1882) ("[I]t is of no moment [to an executor] whether the one or the other side in [the] controversy succeed[s]" since the executor would not get the funds anyway); *Farmers' Bank v. Hayes*, 58 F.2d 34, 36 (6th Cir. 1932) (board of trust, which had held the funds, made no claim on it and was therefore a nominal defendant); *Colman v. Shimer*, 163 F. Supp. 347, 350–51 (W.D. Mich. 1958) (holding that public estate administrator was merely a nominal party with no substantial legal interest in the controversy, and whose addition to the suit did not affect jurisdiction); *SEC v. DCI Telecommunications, Inc.*, 122 F. Supp. 2d 495, 502 (S.D.N.Y. 2000) (defendant's wife, who had no role in the fraud but received funds from it, was a constructive trustee and therefore a proper relief defendant); *accord SEC v. Harden*, 1:05-CV-354, 2005 WL 2649857 at *4–5 (W.D. Mich. Oct. 17, 2005) (relief defendants were not "custodians" who held money on behalf of others, and therefore had to be released as relief defendants).

[24] No. 01-CV-9058, 2003 WL 837141 (S.D.N.Y. Feb. 13, 2003); for another example, *see SEC v. Lane*, No. 607-CV-1920-ORL22DAB, 2010 WL 98992 (M.D. Fla. Jan. 6, 2010) (default judgment clawing investor funds back from business trust and another company).

[25] *See, e.g.*, *SEC v. Quing N. Wong*, 42 F.R.D. 599 (D. Puerto Rico 1967); *SEC v. General Time Corp.*, 407 F.2d 65 (2d Cir. 1968); *SEC v. Wencke*, 622 F.2d 1363, 1369 (9th Cir.1980) ("federal courts have inherent equitable authority to issue a variety of 'ancillary relief' measures [including those against third parties] in actions brought by the SEC to enforce the federal securities laws.").

[26] *See, e.g.*, *CFTC v. Foreign Fund*, 2007 U.S. Dist. LEXIS 45895 (M.D. Tenn. June 25, 2007) (relief defendants failed to show a legitimate claim to the funds they held, and the funds were therefore disgorged by summary judgment); *cf. SEC v. Ross*, 504 F.3d 1130, 1142 (9th Cir. 2007) (holding that the SEC could not institute summary proceedings against a relief defendant where that party, as an employee of the investment scheme, had demonstrated a legitimate claim to the funds). Sometimes the SEC oversteps its bounds and attempts to impute wrongdoing — and liability — to relief defendants. *See,*

e.g., *SEC v. Huff*, Fed. Sec. L. Rep. P 95, 917 (S.D. Fla. September 30, 2010) (although some relief defendants were subject to disgorgement because they could establish no legitimate claim to the funds they held, they could not be held to be jointly and severally liable for damages since such an action would be "punitive and violates due process because the relief defendant has had no notice or opportunity to defend against charges of wrongdoing.").

[27] *SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991); for insight on the transition from nominal to relief defendants in SEC cases, *SEC v. Colello*, 139 F.3d 674, 675–76 (9th Cir. 1998) (noting that, as of 1998, only a few courts had allowed the SEC to sue nominal defendants to recover fraud proceeds).

[28] *Cherif*, 933 F.2d at 406.

[29] *Id*. at 407.

[30] *Id*. at 413–15.

[31] *Id.* at 414 (internal citations omitted).

[32] *Id.* at 415.

[33] *See, e.g.*, *Janvey v. Adams*, 588 F.3d 831, 834 (5th Cir. 2009); *CFTC v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187, 189–90 (4th Cir. 2002); *CFTC v. Walsh*, 618 F.3d 218, 225–27 (2d Cir. 2010); *SEC v. George*, 426 F.3d 786, 798–800 (6th Cir. 2005); *Cherif*, 933 F.2d at 414; SEC v. Ross, 504 F.3d 1130, 1141 (9th Cir. 2007); *SEC v. Founding Partners Capital Mgmt*., 639 F. Supp. 2d 1291, 1293–94 (M.D. Fla. 2009).

[34] *See, e.g.*, *SEC v. Ross*, 504 F.3d 1130, 1146 (9th Cir. 2007); *George*, 426 F.3d at 799.

[35] As the Supreme Court stated in *Brown II* when explaining the concept of equity, "Traditionally, equity has been characterized by a practical flexibility in shaping its remedies…" *Brown v. Board of Education*, 349 U.S. 294, 299 (1955); *see also Hecht Co. v. Bowles*, 321 U. S. 321, 329–330 (1944) ("The essence of equity jurisdiction has been the power of the Chancellor to do equity and to mould each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it. The qualities of mercy and practicality have made equity the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims."). However, courts sitting in equity do rely on precedent and persuasive authority, and where precedential and persuasive authorities are clear, predictability can exist in equitable decisions.

[36] 426 F.3d 786, 798–800 (6th Cir. 2005).

[37] Although there is some contention whether pre-receivership interest

payments should be treated as part of the principal amount, courts are generally favorable to this simple, rational plan. That is, any payment made to an investor from a scheme that is later shown to be fraudulent, which is below her principal — whether it is called an interest payment or otherwise — should be treated as part of the principal amount for calculating legitimate claim and for determining pro rata payments out of the receivership. *See e.g.*, *SEC v. AmeriFirst Funding, Inc.*, No. CIV.A.3:07-CV-1188-D, 2008 WL 919546 (N.D. Tex. Mar. 13, 2008); *SEC v. Byers*, 637 F. Supp. 2d 166, 182 (S.D.N.Y. 2009), *aff'd*, No. 10-312-CV, 2010 WL 4185097 (2d Cir. Oct. 25, 2010), and *aff'd sub nom. SEC v. Malek*, No. 09-3583-CV, 2010 WL 4188029 (2d Cir. Oct. 25, 2010).

[38] For discussion of the protection of principal outside the relief defendant context, *see Wiand v. Waxenberg*, 611 F. Supp. 2d 1299, 1321 (M.D. Fla. 2009) (defrauder's wife's principal amount could not be clawed back); *In re First Commercial Management Group, Inc.*, 279 B.R. 230, 236 (N.D.Ill. 2002) ("[E]stablished principles of Ponzi scheme jurisprudence [prove that] when facing fraudulent conveyance actions, investors may keep the principal amount of their investments, but they may not keep any profits from the scheme."); *Wiand v. Mitchell*, No. 8:06-CV-1085-T-27MSS, 2007 U.S. Dist. LEXIS 24069 at *7 (M.D. Fla. Mar. 27, 2007), *citing Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995); *Mays v. Lombard*, No. 3:97-cv-1010, 1998 WL 386159 (N.D. Tex. 7-2-1998); *Terry v. June*, 432 F. Supp. 2d 635, 642–43 (W.D. Va. 2006).

[39] *See, e.g.*, *CFTC v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187, 192 (4th Cir. 2002), *SEC v. Ross*, 504 F.3d at 1133 (9th Cir. 2007); *CFTC v. Walsh*, 618 F.3d 218 (2d Cir. 2010).

[40] *SEC v. George*, 426 F.3d 786 (6th Cir. 2005).

[41] *Id.* at 788.

[42] *Id.*

[43] *Id.*

[44] *SEC v. Thorn*, No. 2:01-CV-290, 2003 U.S. Dist. LEXIS 5709 (S.D. Ohio Mar. 28, 2003).

[45] *George*, 426 F.3d at 791.

[46] *Id.*, citing *Thorn*, 2003 U.S. Dist. LEXIS 5709 at *2. For further discussion of gift-holding relief defendants, *see SEC v. Better Life Club of Am., Inc.,* 995 F. Supp. 167 (D.D.C.1998) ("gratuitous transferees who hold funds in constructive trust for defrauded investors" cannot establish a legitimate claim

to the funds).

[47] *Id.*

[48] *Id.*

[49] *Id.*

[50] *Id.* at 798.

[51] As other courts have recognized, there is no need to demonstrate the full bundle of ownership rights to avoid disgorgement as a relief defendant; all that must be shown is a legitimate claim or ownership interest — something that undoubtedly is created by investing funds and receiving contractual returns on those funds. *See, e.g.*, *Janvey v. Adams*, 588 F.3d 831, 834 (5th Cir. 2009) (*citing Kimberlynn Creek Ranch*, 276 F.3d 187, 191 (4th Cir. 2002); *SEC v. Cherif*, 933 F.2d 403, 414 (7th Cir.1991); *SEC v. Founding Partners Capital Mgmt*., 639 F. Supp. 2d 1291, 1294 (M.D. Fla. 2009) (a legitimate claim or ownership interest "does not require possession of the full bundle of ownership rights that may exist in various types of property.")).

[52] *George*, 426 F.3d at 798.

[53] *Id*. (emphasis added).

[54] Tracing has not traditionally been important in Ponzi scheme receiverships. For example, in *United States v. Durham*, 86 F.3d 70 (5th Cir. 1996), the Fifth Circuit found that the district court had not abused its discretion by forcing pro rata distribution, even though the largest investors had traced their funds and wanted their principal back.

[55] *George*, 426 F.3d at 798 (internal citation omitted).

[56] *Id.* at 791.

[57] *Id.* at 788.

[58] 648 F. Supp. 2d 202, 222 (D. Mass. 2009), aff'd, 624 F.3d 1 (1st Cir. 2010).

[59] Here, the entity at issue was a close corporation, and Mount was a shareholder. For purposes of determining whether she had a legitimate claim, these facts make no difference and the court gave the proper analysis. To be a relief defendant, she must not have been accused of wrongdoing — not even wrongdoing imputed to an insider of a close corporation — and she must have been holding funds to which she had no legitimate claim. She was not accused of wrongdoing, but there was at least a possibility of a legitimate claim to the distribution, which may have been compensation or a dividend payment. Notwithstanding the fact that Mount was a shareholder in a close corporation, if she either worked for the money (which is possible under the facts and mentioned by the court) or received a return on investment, she had

a legitimate claim to the funds.

[60] In this vein, it must be noted that investors' principal is protected — as long as they invested reasonably equivalent value and received returns in good faith — even in the Uniform Fraudulent Transfer Act, which provides, in nearly every state, a cause of action (outside of the bankruptcy context) under which fraudulent transfers can be avoided. *See, e.g.*, FLA. STAT. ANN. § 726.109 (West).

[61] *Johnson v. Studholme*, 619 F. Supp. 1347, 1348–49 (D. Colo. 1985), *aff'd sub nom. Johnson v. Hendricks*, 833 F.2d 908 (10th Cir. 1987).

[62] *Chosnek v. Rolley*, 688 N.E. 2d 202, 210–11 (Ind. App. 1997).

[63] *SEC v. Elliott*, 953 F.2d 1560, 1569–70 (11th Cir. 1992), *rev'd in part on other grounds*, 998 F.2d 922 (11th Cir. 1993).

[64] *SEC v. Infinity Group*, 993 F. Supp. 324 (E.D. Penn. 1998).

[65] *SEC v. Amerifirst Funding*, No. 3:07-CV-1188-D, 2008 WL 1959843 (N.D. Tex. May 5, 2008); *cf. CFTC v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187, 192 (4th Cir. 2002) (stating that services rendered to an employer is a way of demonstrating a legitimate claim); *S.E.C. v. Founding Partners Capital Mgmt.*, 639 F. Supp. 2d 1291, 1293–94 (M.D. Fla. 2009) (a debtholder, with whom the entity in receivership had a longstanding loan agreement, had to be released because such a debtor-creditor relationship — like employment relationships spoken of in *Kimberlynn Creek Ranch* — "constitutes a sufficient legitimate ownership interest to preclude treating Sun Capital as a relief defendant.").

[66] *Infinity Group*, 993 F. Supp. at 331.

[67] *Id.*

[68] *Id.*

[69] *Amerifirst Funding*, 2008 WL 1959843 at *1.

[70] *Id.*

[71] *Id.* at *5.

[72] *Id.*

[73] *See*, *e.g.*, *Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995) (Ponzi scheme receivership, in which receiver pursued full defendants under the Uniform Fraudulent Transfer Act, which requires that a defendant defend herself by showing that she entered into the investment in good faith and gave reasonably equivalent value for it).

[74] *Amerifirst Funding*, 2008 WL 1959843 at *5 (*quoting SEC v. DCI Telecomms., Inc.*, 122 F. Supp. 2d 495, 502 (S.D.N.Y. 2000)).

[75] Another case with analysis favorable to relief defendants attempting

to establish a legitimate claim based on the rendering of services (if not employment in the traditional sense) is *CFTC v. Sarvey*, No. 08-C-192, 2008 WL 2788538 (N.D. Ill. July 17, 2008), in which the court found that relief defendant Bonfitto (and his company, Bonfitto Trading) had provided services — in the form of risky trade guarantees over a long period — to the defendant Sarvey in return for compensation. The court noted that, "[T]he issue here is not who has the greatest right to the funds. Bonfitto and Bonfitto [T]rading are impled as nominal defendants. As such, the only question is whether they have any legitimate ownership interest in the property at issue. If they do, they may not be impled as merely nominal defendants…. Similarly, it is irrelevant whether Bonfitto and Bonfitto trading acted in "good faith" in receiving the funds. Plaintiffs may not name parties as nominal defendants while also implying that they violated the law…. If the Commission wants to asserts [sic] that Bonfitto and Bonfitto Trading obtained the property by some means that implies complicity in wrongdoing, it should implead them as outright defendants, not nominal defendants." *Id.* at 4–5 (citations omitted).

[76] *SEC v. Ross*, 504 F.3d 1130, 1133 (9th Cir. 2007).

[77] *Id*. at 1151.

[78] *Id*. at 1142.

[79] *Id*. at 1151.

[80] *Id*.

[81] *Id*. at 1142.

[82] *CFTC v. Walsh*, 618 F.3d 218 (2d Cir. 2010).

[83] *Id*. at 221.

[84] *Id*. at 222.

[85] *Id*. at 221–22.

[86] *Id*. at 225–26.

[87] *Id*. at 226–27. Although the court mixes fraudulent transfer law with the relief defendant concept, it does so only to analogize and to help determine what a legitimate claim might mean in this particular instance.

[88] *Id*.

[89] *Id*. at 228–29.

[90] *Id*.

[91] *Id*. at 230–231.

[92] *See, e.g.*, *Scholes v. Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995).

[93] *See* First Amended Complaint, *SEC v. Stanford*, No. 3:09-cv-0298-N (N.D. Tex. Feb. 27, 2009).

[94] *See* Indictment of Robert Allen Stanford, Laura Pendergest-Holt, Gilberto Lopez, Mark Kuhrt, and Leroy King, *United States v. Stanford*, No. H-09-342, (S.D. Tex. June 18, 2009).
[95] Although Janvey was appointed receiver of the entire SFG umbrella, the headquarters of Stanford International Bank were in Antigua — which is where all of the records and books were. Antigua appointed its own liquidators with possession of the bank's records, and Janvey battled with the Antiguan liquidators for some time; in fact, Janvey struggled for months to be recognized as the authoritative receiver in such countries as Canada and the UK — each of which had significant Stanford assets. Who is recognized to represent SFG in different countries is still unclear. This turf war made work cumbersome for Janvey, because instead of having the bank records, he and his high-paid team had to sort through SGC records, some of which had little or nothing to do with SIBL. For an explanation, and documentation, of these struggles for jurisdiction, *see* the Examiner's website, Examiner — Stanford Financial Group, under the heading "Petition for Recognition by Antiguan Liquidators of SIB," http://www.lpf-law.com/sub/stanford.jsp (last visited Dec. 4, 2010).
[96] Amended Order Appointing Receiver, *supra* note 1.
[97] *Janvey v. Adams*, 588 F. 3d 831, 833 (5th Cir. 2009).
[98] Clifford Krauss, *1,000 Stanford Financial Workers Dismissed to Save Company Assets*, N.Y. Times, March 6, 2009, available at http://www.nytimes.com/2009/03/07/business/07stanford.html.
[99] Order Granting in Part and Denying in Part Receiver's Motion for Order Freezing Assets Held in the Names of Certain Relief Defendants, *Janvey v. Alguire*, No. 03:09-CV-0724-N (N.D. Tex. Aug. 4, 2009); *Janvey v. Adams,* 588 F.3d 831 (5th Cir. 2009).
[100] *See* Receiver's First Amended Complaint against Former Stanford Employees, *Janvey v. Alguire*, No. 3:09-cv-00724-N (N.D. Tex. Dec. 7, 2009) (adding 202 defendants); Receiver's Complaint Against Certain Stanford Investors, *Janvey v. Venger*, No. 3:10-cv-366-O (N.D. Tex. Feb. 23, 2010) (adding 505 defendants).
[101] *See, e.g.*, Kristen Hays, *Stanford Receiver: Relief Is on the Way*, Houston Chron., March 16, 2009, available at http://www.chron.com/disp/story.mpl/front/6314677.html.
[102] Order, *SEC v. Stanford*, No. 3:09-CV-0298-N (N.D. Tex. June 29, 2009).
[103] *See generally* Receiver's Amended Complaint Naming Relief Defendants

at 2, No. 03:09-CV-0724-N (N.D. Tex. July 28, 2009); *see also* Brief of Appellant Ralph S. Janvey, No. 3:09-CV-0724-N (5th Cir. Sept. 11, 2009).

[104] *Id*. ("CD Proceeds — loans, commissions, bonuses or other compensation paid to financial advisors for selling CDs, and interest or redemptions to investors — are little more than stolen money and do not belong to persons who received such funds but belong instead to the Receivership Estate.").

[105] *Id*. at 13 ("Relief Defendants do not have any rightful ownership interest that could justify their retaining possession of these funds, which are properly considered assets of the Receivership Estate.").

[106] Plaintiff's Emergency Motion to Modify Receivership Order, *SEC v. Stanford*, No. 3:09-cv-0298-N (N.D. Tex. July 20, 2009). The SEC said that it should be the only party with power to pursue clawbacks from relief defendants and that the receiver's misinterpretation of the law, which, Janvey argued, permitted him to seek principal, was harming investors. Given the SEC's firm stance that principal was protected but interest was not, the Fifth Circuit's ultimate ruling — that investors had a legitimate claim to both principal and interest — may have been an unforeseen boon for investors.

[107] *See generally* Transcript of Oral Arguments before the Fifth Circuit Court of Appeals, *Janvey v. Alguire*, No. 09-10761 (5th Cir. Nov. 2, 2009) (SEC attempted to prevent Janvey from seeking investors' principal by seeking a modification to his order).

[108] *See* Stanford Financial Group Receivership, under heading "Receiver Statement Regarding Court Hearing Addressing Clawbacks," http://www.stanfordfinancialreceivership.com (last visited December 5, 2010).

[109] Judge Godbey also recognized the results of Janvey's zealousness, telling him that "everyone in the courtroom is angry with you." Jeff Carlton, *Lawyer Wants 34% of Money Recovered in Stanford Case*, US NEWS, August 14, 2009, available at http://www.usatoday.com/money/industries/brokerage/2009-08-14-stanford-attorney_N.htm.

[110] Order Granting in Part and Denying in Part Receiver's Motion for Order Freezing Assets Held in the Names of Certain Relief Defendants, *Janvey v. Alguire*, No. 03:09-CV-0724-N (N.D. Tex. Aug. 4, 2009).

[111] Order Extending Injunction, *Janvey v. Alguire*, No. 09-10761 (5th Cir. August 11, 2009); Order Extending Injunction, *Janvey v. Letsos*, No. 09-107615 (5th Cir. August 11, 2009).

[112] Transcript of Oral Argument Before the Fifth Circuit Court of Appeals at 1, *Janvey v. Alguire*, No. 09-10761 (5th Cir. Nov. 2, 2010). The only party at oral

argument to claim that investors had a legitimate claim both to principal and interest was Michael Quilling, an ex-receiver and attorney for various investor relief defendants. *Id.* at 41. The Examiner only advocated that investors keep up to their principal amount. *Id.* at 31. The SEC focused on the freeze, saying that it should be lifted because the receiver could not fulfill the elements of a preliminary injunction. *Id.* at 44–47. Thus, the Fifth Circuit's ruling that investors have a legitimate claim to both principal and interest may have been unanticipated by even the SEC.

[113] 276 F.3d 187 (4th Cir. 2002) (holding that where a trial court does not find credible the factual basis of a relief defendant's asserted legitimate claim — here, unverified testimony that the relief defendant had performed services in return for exorbitant payments and credit card charges — the court can disregard that claim and order disgorgement).

[114] *Janvey v. Adams*, 588 F.3d 831, 834–35 (5th Cir. 2009). The court in oral arguments focused some of its attention on the fact that the SEC was opposed to Janvey's pursuit of principal, whereas in *George* and *Kimberlynn Creek Ranch* the regulatory authority supported the actions. Transcript of Oral Argument, *supra* note 112, at 18–21. The court seemed to suggest that, if the SEC had wanted to pursue the investors as relief defendants, the receiver might have a stronger case. Such reasoning is, in my view, faulty and dangerous. It questions not whether the relief defendant falls under the definition of a relief defendant, but whether the plaintiff wants to pursue the person as a relief defendant. Thus, the reasoning places too much power in the hands of the regulatory agencies and gives insufficient weight to the actual definition that everyone agrees on.

[115] This result might reasonably be adjusted downward to include only principal in other situations, particularly where investors do not hold certificates of deposit with a face value and specific interest amount. That is, where a person is an equity holder rather than a debt holder, a court might find that, in light of the risk and, perhaps, ownership rights, equity calls for finding a legitimate claim in the principal amount invested but not interest. Here, however, the Stanford investors held notes that created a contractual relationship with the bank, and both principal and investment amounts were covered under that contract.

[116] 588 F.3d at 834–35 (citations omitted).

[117] *Id.* at 835 (*quoting CFTC v. Kimberlynn Creek Ranch*, 276 F.3d 187, 192 (4th Cir. 2002)).

[118] *Id.* at n. 2 ("The *George* court did not indicate any intention to depart from the precedents on which it relied. The opinion does not cast any doubt upon our conclusion that the Investor Defendants here, against whom no wrongdoing has been alleged, have ownership interests in and legitimate claims to the proceeds of the CDs that they purchased from the Stanford Bank just as thousands of other innocent investors have done.").
[119] *See, e.g.*, *May, 2010 Survey — Federal Regulation of Securities, Annual Review of Federal Securities Regulation* 65 Bus. Law. 923, 963 ("[I]t will be important to early investors in Ponzi schemes … for the courts to thrash out the criteria for determining when those early investors get to keep their money, and when they must give it back for placement in a pool from which they will then be paid only a pro rata share.").
[120] *In re Independent Clearing House Co*., 41 B.R. 985, 1005 n.20 (Bankr. Utah 1984), *aff'd in part, rev'd in part*, 77 B.R. 843, 855 & n.19 (D. Utah 1987) (holding that the bankruptcy court properly rejected the trustee's attempt to avoid all transfers to the Ponzi scheme's investors, since, "Even were we to find for the trustee on his first theory, the result here would not be equitable.").
[121] *See* Brief of Intervenor John J. Little, Court-Appointed Examiner at Appendices, *Janvey v. Alguire*, No. 09-10761 (5th Cir. Sept. 30, 2009).
[122] For example, Phillip Preis, Esq., represented some 63 investors. *Id.* at ii.
[123] Some relief defendants were added sooner than July. For example, many of the financial advisors were added on April 15. Receiver's Complaint Naming Stanford Financial Group Advisors as Relief Defendants, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Apr. 15, 2009).
[124] *See, e.g.*, Receiver's Amended Complaint Naming Relief Defendants at 4, *Janvey v. Adams*, No. 03:09-CV-0724-N (N.D. Tex. July 28, 2009).
[125] *See, e.g.*, Svea Herbst-Bayliss, *Pershing Ready to Handle Stanford Requests*, Reuters, March 5, 2009, http://www.reuters.com/article/idUSTRE5247SL20090305 (some investors had been relying on their brokerage accounts and investment proceeds for such necessities as rent, groceries, and payroll); *see also* Transcript of Oral Argument, *supra* note 112, at 38–40 (description of how deeply the improper freeze was affecting, for example, retirees and pension funds).
[126] *See, e.g.*, Svea Herbst-Bayliss, *Bystanders Pulled into Stanford Financial Mess*, Reuters, Feb. 20, 2009, http://www.reuters.com/article/idUSTRE51J6CY20090220 (many who had not invested in the CD had their accounts frozen).

[127] *See, e.g.*, Second Order Authorizing Release of Certain Customer Accounts, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. March 12, 2009).
[128] *See, e.g.*, Order Granting Receiver's Unopposed Motion to Approve Procedures to Apply for Review and Potential Release of Accounts, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N, (N.D. Tex. March 27, 2009) (giving Janvey the power to agree, with some investors, on the amount that he would unfreeze).
[129] Order, *supra* note 102.
[130] This number is smaller than the 913 total relief defendants because some relief defendants did not have accounts with the brokerages to which Janvey had access.
[131] Receiver's Amended Complaint Naming Relief Defendants at Appendix, *Janvey v. Alguire*, No. 03:09-CV-0724-N (N.D. Tex. July 28, 2009).
[132] *Adams*, 588 F.3d at 834.
[133] The announcement and instructions for obtaining control of accounts were immediately posted to the receiver's website: Stanford Financial Group Receivership, at heading "Release of Remaining Frozen Investor Accounts Following Fifth Circuit Ruling Regarding Claw Backs," http://www.stanfordfinancialreceivership.com/#FrozenRelease (last visited Dec. 5, 2010).
[134] *See, e.g.*, Receiver's Amended Complaint Naming Relief Defendants at 7, *Janvey v. Alguire*, No. 03:09-CV-0724-N (N.D. Tex. July 28, 2009).
[135] *See, e.g.*, *Perdue v. Kenny*, 130 S.Ct. 1662, 1673 (2010) (approving of Georgia's lodestar method (including lodestar enhancements for particularly superior attorney performance), which compares fees in the area for similar services and uses various factors to determine reasonableness of fees, without requiring subjective analysis like that under the *Johnson* factors).
[136] When considering whether a fee award is reasonable, *Johnson v. Ga. Highway Express, Inc.*, 488 F.2d 714, 717–19 (5th Cir. 1974) sets out the twelve factors the court should consider: "(1) the time and labor involved; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to the acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the political 'undesirability' of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases."

[137] Order Regarding the Receiver's Third Fee Application at 2, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Feb. 3, 2010).
[138] *Id.*
[139] The SEC and the examiner actually argued that the Receiver should receive nothing for work done during this time.
[140] Jeff Carlton, *Lawyer Wants 34% of Money Recovered in Stanford Case*, US News, August 14, 2009, available at http://www.usatoday.com/money/industries/brokerage/2009-08-14-stanford-attorney_N.htm.
[141] Reply in Support of Receiver's Motion for Approval of Second Interim Fee Application at 1, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Sept. 1, 2009). In his first and second applications for the payment of fees and expenses, representing fees incurred from February 17 to May 31, 2009, the receiver asked for $27.57 million from the receivership. Receiver's Motion for Approval of Interim Fee Application and Procedures for Future Compensation of Fees and Expenses and Brief in Support at 1, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. May 15, 2009) (first fee application); Receiver's Motion for Approval of Second Interim Fee Application and Brief in Support at 1, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Aug. 4, 2009) (second fee application). On September 10, 2009, the court largely followed the SEC and examiner's recommendations to temporarily reduce the fees by 20 percent (potentially recoverable later) and to disallow $2.1 million until it was supported by sufficient information. *See* Examiner's Archived Web Entries as of July 10, 2010 at 4, available at http://www.lpf-law.com/UserFiles/File/2010%20Docs/Archive_No3_071010.pdf (last visited Nov. 5, 2010). Thus, Janvey and his team received some $20.3 million for the first hundred days. By late 2009, Janvey had asked for another $13.79 million in his third and fourth applications, representing mainly fees incurred from June 1 to September 30, 2009. Receiver's Motion for Approval of Third Interim Fee Application and Brief in Support at 1, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Oct. 2, 2009) (third fee application); Examiner's Archived Web Entries as of July 10, 2010 at 4, available at http://www.lpf-law.com/UserFiles/File/2010%20Docs /Archive_No3_071010.pdf (last visited Nov. 5, 2010) (detailing Janvey's fourth fee application). In early February 2010, the court agreed with the Receiver, Examiner, and SEC's jointly-proposed fee structure, temporarily discounting the bulk of the third and fourth applications by 35 percent (and the $2.1 million, now supported by more information, was discounted by 20 percent), and authorizing immediate

payment of $10.39 million to the receiver. Order for the Payment of Fees, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Feb. 3, 2010). For work from October 1, 2009 to April 30, 2010, Janvey received $11.13 million, even after the 20 percent holdback agreed to by the SEC and the Examiner. Order for the Payment of Fees, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Apr. 16, 2010); Order for the Payment of Fees, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Jun. 22, 2010); Order for the Payment of Fees, *SEC v. Stanford Int'l Bank*, No. 3:09-cv-00298-N (N.D. Tex. Aug. 11, 2010).

[142] At least one court has explicitly considered and rejected the type of redistribution scheme addressed in *George*. In *SEC v. Byers*, 637 F. Supp. 2d 166, 182 (S.D.N.Y. 2009), aff'd, No. 10-312-CV, 2010 WL 4185097 (2d Cir. Oct. 25, 2010) and aff'd sub nom. *SEC v. Malek*, No. 09-3583-CV, 2010 WL 4188029 (2d Cir. Oct. 25, 2010), the court agreed with the receiver that a *George*-like approach would be unwieldy and harmful: "[T]he Court could order investors to repay all the cash distributions they received from the Wextrust entities, and then the Receiver could make a distribution based on each investors' actual investment. *The practical problems associated with this approach, however, preclude it from being a viable option. Many of the investors may not have the money, and litigation to collect it would be expensive, time-consuming, and, in some instances, cruel.*" (emphasis added). Janvey, facing an even more complicated and widespread fraud, should have followed this reasoning.