09-10761

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RALPH S. JANVEY,

Plaintiff – Appellant–Cross-Appellee,

v.

GAINES D. ADAMS; NEN FAMILY TRUST; JEFF P. PURPERA, JR.; CHERAY ZAUDERER HODGES; LUTHER HARTWELL HODGES; ET AL 1; JOSEPH BECKER; TERRY BEVEN; KENNETH BIRD; JAMES BROWN; MURPHY BUELL; ET AL 2; JAMES RONALD LAWSON; DIVO MILAN HADDAD; SINGAPORE PUNTAMITA PTE., LTD.; NUMA L. MARQUETTE; GAIL G. MARQUETTE,

Defendants – Appellees–Cross-Appellants,

JAMES R. ALGUIRE; VICTORIA ANCTIL; SYLVIA AQUINO; JONATHAN BARRACK; NORMAN BLAKE; ET AL; TIFFANY ANGELLE; MARIE BAUTISTA; TERAL BENNETT; SUSANA CISNEROS; RON CLAYTON; ET AL 3; HANK MILLS; ROBERTO ULLOA; JAY STUART BELL; GREGORY ALAN MADDUX; DAVID JONATHAN DREW; ANDRUW RUDOLF BERNARDO JONES; CARLOS FELIPE PENA; JOHNNY DAVID DAMON; BERNABE WILLIAMS; PATRICIA A. THOMAS, in her capacity as independent executor of the estate of Christopher Allred; PATRICIA A. THOMAS; ROLAND SAM TORN; PAULA MARLIN,

Defendants – Appellees

Consolidated with
09-10765

RALPH S. JANVEY, in his Capacity as Court-Appointed Receiver,

Plaintiff – Appellant

v.

JIM LETSOS; FELIPE GONZALEZ; CHARLOTTE HUNTON; RICHARD O HUNTON; CHARLES HUNTON,

Defendants – Appellees

On Appeal from the United States District Court for the Northern District of Texas, Dallas Division C.A. No. 3:09-CV-0724-N

REPLY/RESPONSE BRIEF OF
APPELLANT/CROSS-APPELLEE RALPH S. JANVEY

BAKER BOTTS L.L.P.
Kevin M. Sadler
Joseph R. Knight
Susan Dillon Ayers
98 San Jacinto Blvd., Suite 1500
Austin, Texas 78701
(512) 322-2589
(512) 322-2501 (Facsimile)

ATTORNEYS FOR PLAINTIFF – APPELLANT–
CROSS-APPELLEE

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INTRODUCTION AND SUMMARY

No relief defendant attempts to justify the rule of law on which the district court's order is based. Not one of them claims that it is equitable for several hundred investors to keep money stolen from 20,000 equally innocent investors based upon the mere fortuity that the relief defendants cashed out before government intervention. No one – including the Examiner who is supposed to speak for *all* investors – explains why a court of equity must passively ratify a chance-based distribution of Stanford's meager assets and allow a small percentage of investors to receive a return of 100% or more of their investment while the vast majority receives next to nothing. Yet this kind of inequitable distribution based on good fortune or quick timing is exactly the result that the relief defendants, joined by the Examiner and even the SEC, ask this Court to ratify.

These parties also repeatedly lament that the Receiver is pursuing claims against "innocent investors" as if that label is reason alone for ruling against the Receiver. But such rhetoric serves only to mask their strenuous efforts to dodge the difficult question presented by the collapse of a Ponzi scheme of this magnitude – should a minority of innocent investors be allowed to keep funds stolen from a majority of other innocent investors based simply on the fortuity that the minority cashed out before the scheme collapsed? When there are very limited funds available following the collapse of the scheme, the choice to be made is

whether all equally innocent investors will share the losses equally, or whether, as the relief defendants and others would have it, the law should allow a hugely disproportionate recovery as between two classes – the "lucky and quick" innocent investors, and the "not so lucky and not quick enough" innocent investors.

According to the relief defendants' distorted view of "equity," if any investors are able to retain stolen money because they are beyond the reach of legal process, or are judgment proof, then the relief defendants must be allowed to retain the stolen funds they received. They argue that because, less than nine months into this Receivership, the Receiver has not yet asserted claims against *every* Stanford investor who cashed out early, equity demands that he assert claims against none of them.

But this bizarre concept of equity has nothing to do with the issue on appeal. The district court explicitly stated that its order is based not upon a weighing of the equities but upon a legal conclusion that Stanford placed hundreds of millions of dollars of stolen money beyond reach of the judicial system when it deposited funds into the relief defendants' accounts. This Court should reject the district court's legal conclusion and reject the arguments of those who would replace the rule of law and equity with good luck and quick timing as the guiding principles for deciding which funds stolen from investors should be returned to the Receivership Estate.

Equally unpersuasive is the argument that no investor can be a relief defendant because all of them have identical claims based upon their CD contracts. The dispositive question in this appeal is not whether the relief defendants have claims against the Estate as Stanford creditors – of course they do. The question is whether the relief defendants have a *legitimate* claim for a much greater payment from the Ponzi scheme than thousands of other investors who assert the very same claim. The relief defendants cannot dodge this question on the pretense that each of them has merely obtained the return of "his" or "her" own money. Undisputed evidence establishes that Stanford squandered the relief defendants' money long before their CDs matured. Stanford paid the relief defendants with money that it stole from other investors. No relief defendant has yet established a *legitimate* claim to a disproportionate share of these stolen funds.

Finally, this Court should reject the technical arguments advanced by various relief defendants. Case law amply supports the Receiver's standing to assert the claims at issue. The SEC has no consistent policy against the assertion of claims against innocent investors, and even if it did, no such policy could preclude the Receiver from fulfilling his court-appointed responsibilities. The account freeze requested by the Receiver is not a prejudgment attachment or other procedurally defective artifice; it is an established remedy, well within the discretion of a court that is supervising an equity receivership to issue in aid of the

recovery of assets that should be used to compensate on an equitable basis all those injured by the Stanford fraud. And the relief defendants had proper notice of the hearing.

ARGUMENT

It is neither feasible nor necessary for the Receiver to address every argument in the dozen briefs filed on behalf of appellees/cross-appellants. For example, much of the relief defendants' briefing goes not to the district court's authority to order disgorgement, but to the weight of the equities it should consider. All such arguments are premature, as the district court specifically stated that its decision on the freeze order was not based on a weighing of the equities. This brief will address the dispositive issues and show that (i) the district court has the authority to order equitable disgorgement of stolen money that Stanford distributed before the Receivership, and (ii) there is no technical impediment to the Receiver seeking such relief.

I. The Receiver is likely to prevail on the merits of his claims because a court of equity has the power to remedy Stanford's inequitable distribution of money swindled from thousands of innocent investors.

This appeal distills down to a question of judicial authority. The defining facts are undisputed and without precedent – Stanford was a massive, multi-billion dollar Ponzi scheme that paid a few hundred investors 100 or more cents on their investment dollars, using money that the scheme stole from tens of

thousands of identically-situated investors who will receive but a few pennies. The Receiver contends that this vastly disproportionate distribution of inadequate investor funds is inequitable, and no appellee is bold enough to explicitly argue otherwise. The only question is whether a court of equity is authorized to fashion a meaningful remedy.

A. The Receiver does not have to overcome an affirmative defense to a cause of action that he is not asserting.

The relief defendants, Examiner and SEC curiously spend substantial portions of their briefs arguing that the Receiver should lose based on their flawed analysis of a claim that the Receiver has not even asserted. According to this argument, the Receiver should lose the Estate's claim for equitable disgorgement of stolen funds because, if he had asserted claims under various versions of the Uniform Fraudulent Transfer Act, the Estate would not be able to recover amounts that purport to be return of principal. This is a straw-man argument because the Receiver is not asserting fraudulent transfer claims, and no case holds that he must.

In addition, the argument is built on a false premise laid bare by the very cases cited by the relief defendants. Because the Stanford Ponzi scheme involves actual fraud, the Receiver could recover purported repayment of principal as a fraudulent transfer, and the relief defendants could avoid such recovery only if they established the defense of "good faith." *See, e.g., Donell v. Kowell*, 533 F.3d 762, 771 (9th Cir. 2008) (under California's fraudulent transfer statute, "there is a

'good faith' defense that permits an innocent winning investor to retain funds up to the amount of the initial outlay"); *Scholes v. Lehmann*, 56 F.3d 750, 759 (7th Cir. 1995) (under Illinois's fraudulent transfer statute, a finding of actual fraud by the transferor "would mean that the [transferee] is not entitled to keep *any* part of the money she received from the corporations—provided . . . that she knew or should have known of [the transferor's] fraudulent intent").

In many jurisdictions, the defense of good faith is very difficult to establish when, as here, the transferor commits fraud. "[C]ourts look to what the transferee objectively 'knew or should have known' in questions of good faith, rather than examining what the transferee actually knew from a subjective standpoint." *In re Agric. Research & Tech. Group, Inc.*, 916 F.2d 528, 535-36 (9th Cir. 1990). "At least one court has held that if circumstances would place a reasonable person on inquiry of a debtor's fraudulent purpose, and a *diligent* inquiry would have discovered the fraudulent purpose, then the transfer is fraudulent." *Id.* at 536 (citing *In re Polar Chips Int'l, Inc.* 18 B.R. 480 (Bankr. S.D. Fla. 1982)).

The enormous expense and delay involved in litigating objective good faith, potentially under myriad state-law fraudulent transfer provisions, is one of many reasons why the Receiver has not pursued such litigation. Whether the relief defendants knew or should have known of Stanford's illegal activities is irrelevant

here. A defining characteristic of a relief defendant claim is that no wrongdoing need be alleged – only that the person is holding stolen funds without a legitimate right to keep them. *See SEC v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998); *CFTC v. Kimberlynn Creek Ranch, Inc.*, 276 F.3d 187, 191-92 (4th Cir. 2002); *SEC v. Elfindepan*, No. 1:00-CV-00742, 2002 WL 31165146, at *4 (M.D.N.C. Aug. 30, 2002). *Scholes, Donell* and the other fraudulent transfer cases cited by various relief defendants thus shed no light on the viability of the Estate's equitable disgorgement claims.

B. The Receiver has properly invoked the court's jurisdiction and asserted viable claims against the relief defendants.

This Court should reject the various arguments that the relief defendants are not, in fact, "relief defendants." Some have cast this argument as an issue of subject matter jurisdiction, while others contend that the undisputed facts negate the Receiver's claims. These are two sides of the same coin.

As every party to this case admits, a relief defendant "can be joined to aid the recovery of relief without an assertion of subject matter jurisdiction only because he has no ownership interest in the property which is the subject of litigation." *SEC v. Cherif*, 933 F.2d 403, 414 (7th Cir. 1991). The property at issue here is money that Stanford looted from thousands of innocent investors. The mere fact that the relief defendants *assert* a legitimate interest in these stolen

funds does not defeat jurisdiction. As one circuit court explained in rejecting an identical argument:

> Alternatively, the Relief Defendants contend that the district court could not proceed against them as nominal defendants because they have asserted an ownership interest in the funds . . . . However, a claimed ownership interest must not only be recognized in law; it must also be valid in fact. Otherwise, individuals and institutions holding funds on behalf of wrongdoers would be able to avoid disgorgement (and keep the funds for themselves) simply by stating a claim of ownership, however specious.

Kimberlynn Creek Ranch, 276 F.3d at 192. Similarly, the very case on which most relief defendants rely makes clear that "[c]ourts have jurisdiction to decide the legitimacy of ownership claims made by non-parties to assets alleged to be proceeds from securities laws violations." *Cherif*, 933 F.2d at 414 n.11.

Cherif also exposes as false drama various arguments that the relief defendant mechanism will somehow violate due process. As in *Cherif*, the relief defendants here will be given notice and an opportunity to be heard on the merits of their claimed ownership interest in the disputed property. *See* R. 251-52; *see also, SEC v. Cavanagh*, 155 F.3d 129, 136-37 (2d Cir. 1998) (claim against relief defendant could proceed because she would have a "full opportunity to litigate her rights"); *Elfindepan*, 2002 WL 31165146, at *5 ("the injunction was properly issued and binding as long as the nominal defendant was given the chance to defend the legitimacy of his claim").

So the real question is not one of jurisdiction. It is whether the record before this Court conclusively establishes that the relief defendants' claimed ownership interest in money stolen from other Stanford investors is both recognized in law and valid in fact. *Kimberlynn Creek Ranch*, 276 F.3d at 192. If innocent investors can be relief defendants, then the Receiver has stated viable claims within the district court's ancillary jurisdiction, and this Court should extend the account freezes until the claims are finally adjudicated on their merits.

C. The relief defendants have not conclusively established that they have a "legitimate" claim to money stolen from other investors.

The definition of a "relief defendant" is not in dispute. Courts can order disgorgement or other equitable relief against a relief defendant if "that person: (1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds." *Cavanagh*, 155 F.3d at 136. "[A]mple authority supports the proposition that the broad equitable powers of the federal courts can be employed to recover ill-gotten gains for the benefit of the victims of wrongdoing, whether held by the original wrongdoer *or by one who has received the proceeds after the wrong*." *Colello*, 139 F.3d at 676 (emphasis added). The relief defendants have not cited even one case holding that an innocent investor "who has received the proceeds after the wrong" can never be a relief defendant.

Nor is it seriously disputed that each relief defendant "has received ill-gotten funds." *Cavanagh*, 155 F.3d at 136. The relief defendants do not contest

the evidence that Stanford was able to distribute money to them only by stealing it from other equally-innocent investors. Recognizing that Stanford was a giant Ponzi scheme – which no relief defendant denies – "establishes the fraudulent intent behind the transfers it made." *SEC v. Res. Dev. Int'l, L.L.C.*, 487 F.3d 295, 301 (5th Cir. 2007) (citation omitted).

Accordingly, the relief defendants can win only if the allegations and undisputed evidence establish as a matter of law that the relief defendants "have a legitimate claim to those funds." *Cavanagh*, 155 F.3d at 136. Because the mere existence of the relief defendants' CD contracts – which is all they rely upon – does not establish a legitimate right to a disproportionate distribution of Ponzi scheme proceeds, this Court should reject the district court's conclusion that as a matter of law innocent investors cannot be liable for return of principal. The relief defendants' custodial accounts should remain frozen until the disgorgement claims are finally adjudicated on their merits.

1. The relief defendants cannot distinguish the rationale underlying Circuit precedent on which the Receiver relies.

The Receiver showed in his opening brief that once an investor sends money to a Ponzi scheme, the district court has the equitable power to distribute the investor's money to all victims of the scheme in proportion to their investments, even if this money is traceable to the original investor or held for him in a segregated account. *See, e.g., United States v. Durham*, 86 F.3d 70, 73 (5th

Cir. 1996) (affirming pro rata distribution even though more than 80% of the funds could be traced to a single depositor and deferring to the district court's conclusion that "it seemed inequitable to allow Claremont to benefit merely because the defendants spent the other victims' funds first"); *SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 331 (5th Cir. 2001) (affirming pro rata distribution of funds that were held in a segregated account for one investor and deferring to the district court's conclusion that "the facts did not support a remedy that would elevate the Whitbecks' claim above the other victims").

The relief defendants are thus forced to argue that an illegal scheme such as Stanford can unilaterally defeat this equitable power simply by transferring stolen funds into an account owned by the investor. But no relief defendant has offered a meaningful basis to distinguish between the custodial accounts at Pershing, JP Morgan and SEI, into which Stanford transferred the funds at issue, and the segregated account into which Forex deposited the Whitbecks' investment. The segregated account in *Forex* held only the Whitbecks' investment funds, but it was subject to Forex's control. Here, the district court found and the record establishes that Stanford likewise controlled the relief defendants' accounts. *See* Supp. R. 466-67 ("[w]ith limited exceptions, Pershing and J.P. Morgan could execute transactions in the accounts only upon Stanford's instructions, rather than the [investors'] instructions"). There is no logical basis to conclude that the district

court had power over the Forex-controlled investor account but lacks power over the Stanford-controlled investor accounts.

Moreover, the relief defendants' argument is bad policy and would establish a dangerous precedent for perpetrators of future Ponzi schemes. Insiders typically feel the heat as government regulators prepare to take formal action against a major fraud operation. Here, for example, one of the Stanford vice presidents sent the following email to Allen Stanford several days before the SEC filed the underlying lawsuit:

> We need to come up with a strategy to give preference to certain wires to people of influence in certain countries, if not we will see a run on the bank starting next week. We all know what that means. There are real bullets out there with my name on, David's name and many others and they are very real.

See Supp. R. 1989. The Receiver does not know which, if any, relief defendants Stanford considered to be "people of influence" or which of them cashed out based upon a call from within the organization suggesting the time might be right. But it is a virtual certainty that such calls were made and will be made when future schemes face their imminent demise. The law should not encourage such conduct by providing that if the perpetrators distribute stolen money before the scheme is shut down, then a court of equity cannot undo their handiwork.

Without addressing the policy implications of their position, some relief defendants seek refuge in a *Forex* footnote mentioning that forty five Forex

investors "previously had their investments returned to them." *Forex*, 242 F.3d at 328 n.3. But the opinion does not state when these investments were "returned," whether Forex was insolvent at the time, or whether Forex used money that it stole from other investors. The mere fact that the Forex receiver apparently did not assert disgorgement claims against these forty five investors hardly establishes that the court would have lacked power to award relief if the claim had been asserted. The rationale for this Court's decisions in *Durham* and *Forex* is a sufficient basis for reversing the district court's order and holding that its equitable power extends to stolen money that Stanford placed in the relief defendants' accounts.

2. *George* is indistinguishable precedent supporting the Receiver's claims.

The relief defendants cannot distinguish *SEC v. George*, 426 F.3d 786, 798–99 (6th Cir. 2005). The investors in *George* were ordered to return money that had already been distributed to them. The claims were equitable claims for disgorgement, not legal claims for fraudulent transfer. There was no allegation in *George* that the relief defendants did anything wrong or knew that they received money stolen from other investors. And yet the relief defendants were ordered to disgorge every cent they received from the scheme (plus interest) so that the money could be distributed pro rata to all victims. *See George*, 426 F.3d at 798 ("the SEC showed that the money [the relief defendants] received from the scheme came not from profits on their investments but from the investments of

others," and therefore they "received ill-gotten funds and had no legitimate claim to those funds").

Because it is on all fours with this case, the relief defendants enlist the SEC to help them argue that *George* does not really mean what it says. They literally contend that the SEC's after-the-fact explanation of its internal reasons for asserting equitable disgorgement claims against the investors in *George* ought to somehow change the Sixth Circuit's analysis and negate the precedential value of its opinion.

But *George* cannot be distinguished on the ground that the SEC secretly believed that the relief defendant investors in that case "were not wholly innocent." SEC Amicus Br. at 23. The SEC did not allege – much less conclusively prove – any wrongdoing, and neither the district nor appellate court based its holding on any finding of wrongdoing. The district court rendered summary judgment on disgorgement claims against each relief defendant in *George* not because he knew of the fraud, but solely because the "return" of his investment was paid with money stolen from other investors:

> . . . Jackson, who invested $285,000 with Thorn, received back $282,320 from Thorn, but the SEC traced those funds to contributions from other investors. Jackson did not dispute that the SEC had traced the $282,320 to the contributions of other investors, and accordingly the district court ordered Jackson to disgorge the ill-gotten gains plus $70,721 in prejudgment interest. Harris invested $1,186,000 with Thorn and received $505,920

> from him. Because the SEC traced the $505,920 to other investors' contributions and because Harris conceded that he did not know the source of the funds he received, . . . the district court ordered that he disgorge $505,920 plus $139,867 in prejudgment interest. . . . George had invested $37,000 with the defendants and had received $79,300 in return, but George also presented no evidence identifying the source of the funds he received and admitted that the money could have come from other investors. Concluding that the $79,300 had been obtained illegally from other investors and that George had no legitimate claim to the money, the district court ordered him to disgorge $79,300 plus $13,495 in prejudgment interest.

George, 426 F.3d at 791 (internal citations omitted).

The court of appeals affirmed disgorgement from these investors, despite the fact that they claimed to be ignorant of the fraud, because the investors failed to counter the SEC's evidence that they, like the relief defendants here, were paid with money looted from other investors. *George*, 426 F.3d at 798. When the *George* investors argued that they should at least be permitted to retain sums up to the amount of their investments, the Sixth Circuit rejected their position for precisely the same reasons supporting the Receiver's claims here:

> Jackson, Harris and George contend that the amount of money they invested in the scheme should be subtracted from the amount they have been ordered to disgorge. Not true. Hundreds of other investors were victimized by this scheme, yet they will recover only 42 percent of the money they invested, not the 100 percent to which the relief defendants claim to be entitled. . . . [T]he use of a *pro rata* distribution has been deemed especially appropriate for fraud victims of a "Ponzi scheme" . . . .

> As the Supreme Court explained in the litigation that gave the Ponzi scheme its name, "equality is equity" as between "equally innocent victims." *Cunningham v. Brown*, 265 U.S. 1, 13 (1924). . . . Under these circumstances, [the relief defendants] may not receive a disproportionate share of the recovered investor funds, only the same pro rata share that other investors may receive.

George, 426 F.3d at 799 (internal quotation and citation omitted).

George also defeats the argument urged by many relief defendants here that a court's power to order a pro rata *distribution* of the assets left behind by a fraudulent scheme does not permit the court to *recover* distributions made by the perpetrators before the scheme is shut down. As the Sixth Circuit explained: "The mere coincidence that the defendants chose the relief defendants (instead of others) to *receive* funds contributed by other investors in order to delay the discovery of this scheme does not entitle the relief defendants to preferential treatment." *Id.* (emphasis added) *George* is indistinguishable precedent for the Receiver's disgorgement claims and for an account freeze in aid of the requested relief.

3. The relief defendants' CDs do not establish a legitimate right to cash that Stanford stole from other investors.

Like the unsuccessful investors in *George*, the relief defendants rely upon their CD contracts as the basis for asserting a claim to the money in question. If this superficial contention were enough, then *George* would have come out the other way. Not one of the relief defendants addresses the question posed in the

Receiver's opening brief – how can any CD investor *legitimately* claim a disproportionate amount of the money that Stanford stole from others?

Most of the relief defendants hide from this question behind the pretense that they merely received back their own money. But, as in *George*, none of them cites evidence contradicting the Receiver's proof that Stanford was able to redeem the relief defendants' CDs only by fraudulently diverting money invested by others. *See* Appellant's Br. at 3-7. The relief defendants' claim for a wildly disproportionate share of ill-gotten Ponzi scheme proceeds is no more sophisticated than the playground rule "finders keepers, losers weepers" – hardly a defensible principle of law.

No relief defendant cites a case holding that an investment contract establishes a legitimate claim to keep money stolen from others who have the exact same contractual rights. They rely instead on *SEC v. Founding Partners Capital Management*, No. 2:09-cv-229, 2009 WL 1606491 (M.D. Fla. June 8, 2009), in which the court dismissed the SEC's relief-defendant claims against an entity to which an investment fund made loans. Although the district court in Florida erroneously viewed the concept of a "relief defendant" more narrowly than *George* and the other circuit-court decisions it cites, *Founding Partners* is easily distinguishable on the ground that the court's decision did not result in the

borrower receiving preferential treatment over other borrowers who had identical claims.

In fact, the equivalent rights of other investors was precisely the basis for the SEC's successful disgorgement claims against the relief defendants in *George*. Contrary to the argument in its amicus brief, the SEC's argument in *George* was exactly the same as the Receiver's position here – an investment in a Ponzi scheme does not establish a legitimate right to be repaid in full with money stolen from other investors:

> Harris also argues that he gave Thorn valuable consideration – the $540,000 he invested. *However, the fact that Harris invested with Thorn does not give him a legitimate claim to the other investors' money he received.* All the victims of this fraud invested money with Thorn. Yet none of them, including Harris, has a legitimate basis for claiming that they should be repaid 100-cents-on-the-dollar for even part of their claims, while other victims will receive at best only partial distributions.

R. 387 (emphasis added).

As in *George* but contrary to the situation in *Founding Partners*, the legitimacy of the relief defendants' claim here fails because 20,000 other investors have the exact same claim to the exact same funds. If the relief defendants' CD contracts established a *legitimate* claim to keep all of the stolen money that Stanford distributed to them, then the other investors' CD contracts would necessarily establish a legitimate claim to take the money away from them.

This fact also negates the distinction drawn by the district court between which ill-gotten gains dolled out by Stanford were characterized as principal and which as interest. This is a distinction which, for the reasons shown here, has no justifiable basis in the law. The distributed funds were all ill-gotten gains subject to the authority of the courts to order their marshalling and equitable redistribution, without regard to whether the recipient investor thought some represented principal. Because all investors have equal rights under their CD contracts, and because there is not enough money to satisfy those rights, the CDs logically cannot establish a legitimate claim for more than a proportionate share of the inadequate funds.

D. The Receiver has standing to assert claims for equitable relief.

Some of the relief defendants and, remarkably, the SEC argue that the Receiver lacks standing to pursue claims for equitable relief benefitting the 20,000 innocent investors who stand to recover next to nothing. None of them cites a case holding that the receiver for a Ponzi scheme is without standing to recover stolen money for the benefit of the scheme's victims. The case law and the terms of the order appointing the Receiver in this case establish precisely the opposite.

The general rule that a receiver steps into the shoes of the estate he is appointed to administer does not preclude the receiver from asserting equitable claims to recover ill-gotten gains for the benefit of the estate's creditors. The very

case on which the SEC relies for its argument demonstrates that a court-appointed receiver can assert equitable claims for the ultimate benefit of innocent investors who were victimized by a Ponzi scheme before the receiver's appointment. *See Scholes*, 56 F.3d at 754 (explaining that "[t]he appointment of the receiver removed the wrongdoer from the scene," at which point the estate "became entitled to the return of the moneys—for the benefit not of [the wrongdoer] but of innocent investors"); *see also Donell*, 533 F.3d at 776-77 (following *Scholes* and holding that the receivership estate is "entitled to the return of the moneys—for the benefit not of [the operator] but of innocent investors—that [the operator] had made the corporations divert to unauthorized purposes").

The Receiver's authority here derives not from any cause of action that Stanford could have asserted against the relief defendants before the Ponzi scheme was exposed, but from the Receivership order appointing him to help clean up the mess. This order directs and authorizes the Receiver to "[p]erform all acts necessary to conserve, hold, manage, and preserve the value of the Receivership Estate, in order to prevent any irreparable loss, damage, and injury to the Estate." Supp. R. 185 at ¶ 5(g). The order specifically directs the Receiver to "[i]nstitute such actions or proceedings to impose a constructive trust, obtain possession, and/or recover judgment with respect to persons or entities who received assets or records traceable to the Receivership Estate," Supp. R. 184 at ¶ 5(c), and to

"[i]nstitute… such actions or proceedings in state, federal, or foreign courts that the Receiver deems necessary and advisable to preserve the value of the Receivership Estate, or that the Receiver deems necessary and advisable to carry out the Receiver's mandate under this Order." Supp. R. 185 at ¶ 5(i). The district court stated that its order was "both necessary and appropriate in order to prevent waste and dissipation of the assets of Defendants *to the detriment of investors*." Supp. R. 181 (emphasis added).

One of a receiver's primary responsibilities is to marshal assets for the benefit of estate creditors, most of whom in this case are defrauded investors. *See, e.g., SEC v. Cook*, No. 3:00-CV-272, 2001 WL 256172, at *2 (N.D. Tex. March 8, 2001) ("a receiver represents not only the entity in receivership, but also the interests of its creditors"); *Butcher v. Howard*, 715 S.W.2d 601, 604 (Tenn. Ct. App. 1986) ("there are certain situations where the receiver is permitted to assert rights and defenses not available to the insolvent"); *Terry v. Dowdell*, No. 3:04-CV-67, 2006 WL 2360933, at *1 (W.D. Va. Aug. 11, 2006) (receiver was authorized by appointment order to pursue claims on investors' behalf); *In re Vernon*, No. CIV. S-06-1358-LKK, 2006 WL 2843626, at *7 (E.D. Cal. Oct. 2, 2006) ("it is fundamental that a liquidating receiver represents the interests of depositors and creditors"); *In re U.S. Oil and Gas Litig.*, No. 83-1702-Al-CIV, 1988 WL 28544, at *1 (S.D. Fla. Feb. 8, 1988) ("Receiver Wald ha[d] standing to

pursue claims on behalf of the allegedly defrauded investors in the defunct companies"); *see also* 65 AM. JUR. 2D § 371 (2001) ("A receiver is the embodiment of creditors standing as an agent for them, representing them with the power to do acts that that a mere agent of a defunct company could not do, including the power to bring suits on their behalf.").

E. There is no SEC policy that prohibits the Receiver's claims.

Equally without merit is the contention that only the SEC, not the court-appointed Receiver, should pursue disgorgement claims. As the discussion of *George* above indicates, the SEC has no policy against seeking disgorgement from innocent investors who were paid with money stolen from other investors. Nor does the SEC have any policy against having a court-appointed receiver pursue "claw back" claims in cases of fraud. For example, in a recent case, the SEC itself proposed that a monitor be appointed to perform an "investigation of grounds to claw back payouts" by a fund in receivership. App. B, at 1. The SEC requested that this monitor "in his or her sole discretion, shall determine those claims that should be pursued in the best interests of all Unpaid Shareholders," and should "be appointed receiver for the limited purpose of pursuing such claims ('the Claw Back claims') on a contingency basis" against fund shareholders who received a disproportionate pre-receivership distribution. *Id.* at 2.

Moreover, the SEC filed a separate motion to strip the Receiver of his authority to pursue disgorgement claims, arguing without citation to any case law that the SEC should have a veto power over such claims. The district court denied this motion and no one appealed the ruling. *See* Case no. 3:09-cv-298-N, Doc. 674 (Order Denying Plaintiff's Emergency Motion to Modify Receivership Order). The Receiver answers to the district court, which appointed him and defined his powers, not the SEC. *See Booth v. Clark*, 58 U.S. 322, 331 (1854); *In re San Vicente Med. Partners Ltd.*, 962 F.2d 1402, 1406 (9th Cir. 1992); *SEC v. Elliott*, 953 F.2d 1560, 1577 (11th Cir. 1992); *SEC v. Giacchetto*, No. 00CIV.2502, 2000 WL 943524, at *1 (S.D.N.Y. July 10, 2000).

F. The requested account freeze is not a prejudgment attachment, but rather a recognized device in aid of the court's ability to award equitable relief.

Certain relief defendants and the Examiner contend that the district court is without authority to freeze the relief defendants' accounts because such a freeze is, in effect, an illegal prejudgment attachment pursuant to Rule 64. Other litigants have tried this argument in similar cases, and it fails because the availability of a freeze order in a case based on federal securities law is not governed by Rule 64; state law is therefore irrelevant. "The [freeze] order functions like an attachment. That does not mean, however, that its issuance must be tested against state law standards, as would be the case if the relief were sought

pursuant to rule 64 of the Federal Rules of Civil Procedure." *SEC v. Unifund SAL*, 910 F.2d 1028, 1041 (2d Cir. 1990); *see also Fed. Sav. & Loan Ins. Corp. v. Dixon*, 835 F.2d 554, 560 (5th Cir. 1987) (distinguishing interlocutory freeze order from attachment under Rule 64).

Instead, courts have broad power to mold equitable relief to the particular circumstances of each case. *Fed. Savings & Loan Ins.*, 835 F.2d at 563 (because the receiver is concerned "with the savings of many depositors, the investments of numerous stockholders . . . equity's powers to aid [the receiver] in its endeavors are even broader than for private claims"). Federal equitable principles, not Rule 64, control the exercise of this power. *See Unifund*, 910 F.2d at 1041 ("[I]t is a matter of federal law whether the showing the Commission has made is sufficient to support an interlocutory freeze order."); *SEC v. Hickey*, 322 F.3d 1123, 1131 (9th Cir. 2003) (the district court was authorized to freeze the assets of a non-party "so long as doing so was necessary to protect and give life to" other orders entered against the defendants); *see also Cavanagh*, 155 F.3d at 136 (noting that "an injunction freezing assets of a relief defendant" is reviewed under the ordinary standard of whether the plaintiff has shown that it is likely to succeed on the merits).

G. The proceedings below are not void for lack of notice.

Last and certainly least, some relief defendants contend that the order maintaining a freeze over their accounts to the extent of interest received on their Stanford CDs is void for lack of proper notice under Federal Rules of Civil Procedure 65 and 6. This is nonsense.

First, the freeze order of August 4 merely extended in part an account freeze that had been in place, with the relief defendants' full awareness, for months. Second, no relief defendant argues that he or she did not, in fact, receive notice and an opportunity to be heard at the July 31 hearing. *See, e.g.,* Br. of Divo Milan Haddad *et al.* at 26 (complaining about notice while admitting that "Milan and a few other 'Relief Defendants' had previously been sued by the Receiver, and therefore did receive notice of the July 28 Freeze Motion, which also requests that it be given 'expedited consideration'"); Br. of Adams *et al.* at 25-26 (complaining about lack of proper notice despite having attended and presented argument at the hearing, *see* Tr. 64-69). Of course, the Examiner also attended the hearing and opposed the account freeze on behalf of all relief defendants. *See* Tr. 35-43.

Third and most important, the July 31 hearing was set by the court, and Rule 6 plainly provides that the five-day notice provision does not apply when a court order "sets a different time" for the hearing. *See* R. 19 (07/29/2009 Docket entry); FED. R. CIV. P. 6(c)(1)(C). As explained in Wright, Miller & Kane, in the

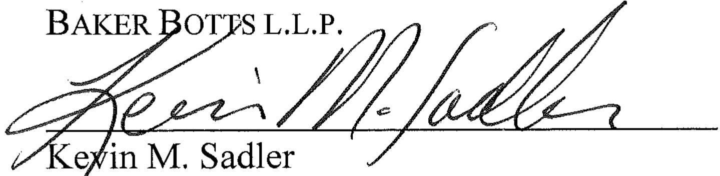
sentence immediately following the one quoted in the Milan brief, "when the urgency that is characteristic of the preliminary injunction context warrants, the court has discretion under Rule 6(d) [now 6(c)] to modify the period for giving advance notice." Wright, Miller & Kane, Federal Practice and Procedure: Civil 2d § 2949, at 213-14 (1995). Because the relief defendants received notice via court order setting the hearing, were actually represented at the hearing, and did not object to a lack of notice or opportunity to prepare, there is simply no basis for deciding this important case on a procedural gotcha.

CONCLUSION AND PRAYER

For all of these reasons, the Receiver prays that this Court reject the first-come, first-served rule of Ponzi scheme distribution urged by the appellees, vindicate the policy that "equality is equity," and hold that the district court abused its discretion in concluding as a matter of law that it is without equitable power to reverse pre-Receivership distributions of stolen money. Based on this holding, the Receiver prays that the Court reverse the district court's order and impose an account freeze to the full extent of the relief defendants' pre-Receivership distributions; alternatively, the Court should at least remand with instructions to reconsider the freeze request in light of this Court's opinion. The Receiver prays for such further relief to which he and the Stanford Estate may be entitled.

Respectfully submitted,

BAKER BOTTS L.L.P.



Kevin M. Sadler
Texas State Bar No. 17512450
Joseph R. Knight
Texas State Bar No. 11601275
Susan Dillon Ayers
Texas State Bar No. 24028302
98 San Jacinto Blvd, Suite 1500
Austin, Texas 78701
(512) 322-2589
(512) 322-2501 (Facsimile)

ATTORNEYS FOR APPELLANT–CROSS-APPELLEE, RALPH S. JANVEY

CERTIFICATE OF SERVICE

I certify that a copy of Reply to Response Brief of Appellant Ralph S. Janvey was served by email and Federal Express on this 14th day of October 2009, to the following counsel of record:

Eugene B. Wilshire
Jacalyn D. Scott
WILSHIRE & SCOTT, P.C.
3000 One Houston Center
1221 McKinney Street
Houston, Texas 77010

David B. Reece
Mike Post
U.S. SEC
100 F Street, NW, Rm 9404
Washington, DC 20549

John J. Little
Stephen Granberry Gleboff
LITTLE PEDERSEN FANKHAUSER
901 Main Street, Suite 4110
Dallas, Texas 75202

Ross D. Kennedy
BRACEWELL & GIULIANI LLP
711 Louisiana St., Suite 2300
Houston, Texas 77002

Bradley W. Foster
Matthew G. Nielsen
ANDREWS KURTH LLP
1717 Main Street, Suite 3700
Dallas, Texas 75201

Cynthia Levin Moulton
MOULTON & MEYER
800 Taft Street
Houston, Texas 77019

Gene R. Besen
SONNENSCHEIN NATH & ROSENTHAL
2000 McKinney Ave
Suite 1900
Dallas, Texas 75201-1858

Joshua Glen Berman
SONNENSCHEIN NATH & ROSENTHAL
1301 K Street, N.W.
600 E. Tower
Washington, DC 20005-3364

M. David Bryant, Jr.
COX SMITH MATTHEWS, INC.
1201 Elm Street, Suite 3300
Dallas, Texas 75720

Mark Joseph Barrera
Deborah Daywood Williamson
COX SMITH MATTHEWS, INC.
112 East Pecan St., Suite 1800
San Antonio, Texas 78205

Michael J. Quilling
Brent Jason Rodine
Marcie Lynn Schout
QUILLING, SELANDER, CUMMISKEY & LOWNDS
2001 Bryan Street, Suite 1800
Dallas, Texas 75201

Michael J. Stanley
STANLEY FRANK & ROSE, LLP
7026 Old Katy Road, Suite 259
Houston, Texas 77024

Jeffrey J. Ansley
BRACEWELL & GIULIANI, LLP
1445 Ross Avenue, Suite 3800
Dallas, Texas 75202

Phillip W. Preis
PREIS GORDON A PLC
450 Laurel St., Suite 2150
Baton Rouge, LA 70801-1817

Monica L. Luebker
Parker D. Young
Russell William Hubbard
FIGARI & DAVENPORT
3400 Bank of America Plaza
901 Main Street, LB 125
Dallas, Texas 75202-3796

Kevin M. Lemley
ALLEN LAW FIRM PC
212 Center Street, 9th Floor
Little Rock, AR 72201

Kendall Kelly Hayden
COZEN O'CONNOR
2300 Bankone Center
1717 Main Street
Dallas, Texas 75201

Brett Feinstein
STRATTON & FEINSTEIN PA
407 Lincoln Road, Suite 2A
Miami Beach, FL 33139

Ruth Brewer Schuster
THE GULF LAW GROUP PLLC
1201 Connecticut Ave NW
Suite 500
Washington , DC 20036

James Scott Annelin
ANNELIN & GASKIN
2170 Buckthorne Place, Suite 220
Woodlands, Texas 77380

Andrew B. Thomson
Rodney Acker
Barton Wayne Cox
Ellen B. Sessions
FULBRIGHT & JAWORSKI
2200 Road Avenue, Suite 2800
Dallas, Texas 75201

James B. Greer
Joseph A. Hummel
Kenneth C. Johnston
KANE RUSSELL COLEMAN & LOGAN PC
1601 Elm Street
Suite 3700
Dallas, Texas 75201

Ashlea Brown
NEWLAND & ASSOCIATES PLLC
10 Corporate Hill Dr., Suite 330
Little Rock, AR 72205

Benjamin D. Reichard
James R. Swanson
Lance C. McCardle
FISHMAN HAYGOOD PHELPS WALMSLEY
WILLIS & SWANSON LLP
201 St. Charles Avenue, 46th Floor
New Orleans, LA 70170-4600

Bart Wulff
SHACKELFORD MELTON & MCKINLEY
3333 Lee Parkway, Tenth Floor
Dallas, Texas 75219

David M. Finn
MILNER & FINN
2828 N Harwood
Suite 1950 LB 9
Dallas , TX 75201

Gene Francis Creely, II
COZEN O'CONNOR
1221 McKinney, Suite 2900
One Houston Center
Houston, TX 77010

Eugene N. Bulso, Jr.
LEADER, BULSO, NOLAND & BURNSTEIN
414 Union Street, Suite 1740
Nashville, TN 37219

T. M. Hobson
LAW OFFICE OF THOMAS MICHAEL HOBSON
1083 Walnut Street
Centreville, AL 35042

Lance Charles Arney
ARNEY LAW FIRM
1401 McKinney, Suite 1800
Houston, Texas 77010

Jeffrey M Tillotson
LYNN TILLOTSON PINKER & COX LLP
2100 Ross Ave
Suite 2700
Dallas , TX 75201

Allyson N. Ho
Rachel Morgan
MORGAN LEWIS & BOCKIUS LLP
1000 Louisiana
Suite 4000
Houston, Texas 77002

Susan Dillon Ayers

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,443 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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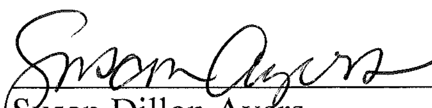

Susan Dillon Ayers
Attorney for Appellant–Cross-Appellee
Ralph S. Janvey

Dated: October 14, 2009

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TAB B The Commission's Amended Term Sheet, Appdx. to SEC's Memo. of Law in *SEC v. Reserve Mgmt.*

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TAB A

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. RESERVE MANAGEMENT COMPANY, INC., RESRV PARTNERS, INC., BRUCE BENT SR. and BRUCE BENT II, Defendants, and THE RESERVE PRIMARY FUND, Relief Defendant.	No. 09 Civ. 4346 (PGG) ECF CASE

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM OF LAW IN RESPONSE TO OBJECTIONS TO ITS APPLICATION FOR INJUNCTIVE AND OTHER RELIEF AND APPROVAL OF THE COMMISSION'S PROPOSED PLAN OF DISTRIBUTION

Nancy A. Brown
Valerie A. Szczepanik
Michael D. Birnbaum
Michael J. Osnato Jr.
SECURITIES AND EXCHANGE COMMISSION
3 World Financial Center
New York, NY 10281
(212) 336-1100

Attorneys for Plaintiff

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Plaintiff Securities and Exchange Commission ("Commission") respectfully submits this Memorandum of Law in Response to Objections to its Application for Injunctive and Other Relief and Approval of the Commission's Proposed Plan of Distribution.

INTRODUCTION

On May 5, 2009, the Commission filed an action against (i) Reserve Management Company, Inc. ("RMCI"), Resrv Partners, Inc. ("Resrv Partners"), Bruce Bent Sr. and Bruce Bent II (collectively "Defendants") for violations of various federal securities laws; and (ii) Relief Defendant The Reserve Primary Fund ("Primary Fund" or "Fund") seeking (a) to enjoin its plan of distribution that would withhold for an indeterminate time at least $3.5 billion in Primary Fund assets from Fund investors; and (b) to approve a more fair and equitable plan of distribution – namely a prompt *pro rata* distribution – to those investors. With its Complaint, the Commission also filed an Order to Show Cause and Application for Injunctive and Other Relief and Approval of the Commission's Proposed Plan of Distribution (the "Application") which sought a scheduling order to set a hearing on the Commission's Application on notice to all claimants to Fund assets.

In response to the Commission's Application, on June 8, 2009 this Court ordered all "claimants against the assets of the Primary Fund, the Defendants [or related individuals to] file any objections to the entry of the relief sought by the Commission" by July 27, 2009. The Court further ordered the Commission and the Primary Fund to notify claimants of their right to object to the Commission's proposed plan of distribution ("Plan"), and ordered the Commission and the Primary Fund to submit any responses to objections by August 21, 2009 in advance of a hearing scheduled for September 23, 2009. Accordingly, the Commission submits this Memorandum to address the objections and other submissions offered by Primary Fund investors, and to reiterate

the compelling equitable grounds supporting a prompt *pro rata* distribution.[1]

In its submission in support of its Application, the Commission showed that the process by which the Fund's Board of Trustees set the Fund's NAV on September 15 and 16, 2008 was so hopelessly and irreparably compromised by inaccurate and incomplete information that it would be impossible and unfair to rely on it to draw distinctions between shareholders.[2] As such, the fact that many investors happen to hold confirmations that they believe entitle them to $1 per share is not controlling here because the NAV set forth in those confirmations is not reliable and was not reliable at the time the confirmations were issued. In light of the unprecedented corruption of the process by which the Fund set its NAV during critical periods of time – including for much of September 15, when the Trustees were unaware of key facts relating to valuations of Lehman in the market, the unprecedented levels of redemptions that the Fund was receiving and the true nature of RMCI's and the Bents' commitment to support the Fund – the Commission believes that a "determination" of the Fund's true NAV cannot now be achieved and that the only fair and equitable manner in which to distribute the Fund's remaining assets is on a *pro rata* basis.

The overwhelming majority of shareholders who have not received $1 per share for their Primary Fund shares ("Unpaid Shareholders") opted not to object to the key features of the

---

[1] Submitted herewith is the Declaration of Michael D. Birnbaum, executed August 21, 2009 ("Birnbaum Decl."), to which is attached those Objections and Responses received by the Commission that were not electronically filed by the party submitting them. Reference to an Objection or Response filed electronically is made by the Docket Entry ("DE") number assigned to each.

[2] On September 15, the Trustees decided that they could no longer use the amortized cost method for calculating the Fund's NAV and were, therefore, required by Rule 2a-4, 17 C.F.R. § 270.2a-4, to calculate the Fund's NAV at market value, or, if there was no market, to make a "good faith" determination of "fair value." (See Henry Ford Health Systems (DE 131) at 4-5; TD Ameritrade (DE 70) at 10.)

Commission's Plan.[3] Investors across the spectrum support, or at least accept, the Commission's Plan, ranging from the earliest of redeemers to the latest, and the largest of investors to the smallest. Many of these shareholders have colorable claims to redemptions at $1 per share but recognize that the events of September 15 and 16, and the absence of a reliable NAV for the Fund, render moot the notion of a valid $1 redemption.

As one would expect in this challenging economic climate, most shareholders seek a fair and fast distribution and recognize that the Commission's Plan will best achieve that result. There is no question that, as this Court recently noted "[t]here is a finite amount of money here. And multiple litigations . . . can only drain away assets from the Fund to the detriment of all shareholders." (Tr. of Aug. 5, 2009 10 a.m. Conf. at 3.)

Critically, even those few objectors who challenge the Commission's proposed *pro rata* distribution ("Objectors") do not support as fair or equitable the plan of distribution announced by the Primary Fund – a plan that would effectively halt all further distributions to any investors in order to fund an enormous "Special Reserve" to benefit the Fund's Trustees and individuals other than investors.[4] Moreover, as set forth below, courts in and out of this Circuit routinely have approved the kind of distribution plan the Commission proposes here in contexts ranging from receiverships, to "fair funds," to class action settlements where there exist, as here, limited

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[3] Several investors submitted memoranda supporting the Commission's proposed *pro rata* distribution of Fund assets while either seeking clarification of certain details of the Commission's Plan or proposing amendments to the Plan. The Commission addresses those questions and comments below, and seeks to accommodate many of the suggestions without unfairly prejudicing the rights of any shareholders. As an Appendix to this Memorandum, the Commission submits its Amended Plan that includes additional provisions that are consistent with the Plan as originally proposed.

[4] Furthermore, no investor appears to challenge the Commission's authority to pursue, or this Court's authority to grant, an injunction preventing the Fund from proceeding with its plan; the most strident objection merely points to the Commission's infrequent invocation of its authority. (E*TRADE Obj. (DE 76) at 8.)

assets to satisfy many competing claims.

Thus, the critical inquiry, as highlighted by several Objectors, is whether the Commission's proposed Plan itself is fair and equitable. Those Objectors who argue that it is not almost uniformly base their objections on the purported strength of their "contract" claim: as holders of $1 confirmations from the Fund, they claim an inviolate contractual right to a $1 per share redemption, even though their claims are based on the illusory and erroneous proposition that the Fund's NAV accurately was determined at $1 when the confirms were issued. The contract claimants also overlook that every shareholder – including those that chose to redeem later in the process, or not at all – had the right to have the NAV accurately calculated at all times. The payout to some investors of a finite pool of assets at an artificial $1 price would inevitably deprive other investors of funds to which they may be entitled.

Declining to exercise this Court's jurisdiction over the Primary Fund and to determine all claimants' rights to the *Res* at this juncture will likely lead to a particularly unfair and inequitable *de facto* distribution plan under which each investor's recovery will be determined by the speed at which any particular claimant can perfect judgment against the *Res* in whatever court or courts ultimately decide the merits of the approximately 37 actions currently pending against the Fund. Such a result would itself constitute a *de facto* plan of distribution that would be unfair and inequitable under Section 25(c) of the Investment Company Act.

Accordingly, the Objectors' challenges to the Plan should be rejected, and the Fund should be compelled to distribute assets remaining in the *Res* to investors on a *pro rata* basis pursuant to the terms of the attached Appendix.

ARGUMENT

I. THIS COURT HAS CLEAR STATUTORY AUTHORITY TO ENJOIN THE PRIMARY FUND'S PROPOSED PLAN OF DISTRIBUTION.

Section 25(c) of the Investment Company Act expressly confers upon this Court the authority to "enjoin the consummation of any plan of reorganization of [a] registered investment company upon proceedings instituted by the Commission ... [where] such a plan is not fair and equitable to all security holders."[5] Here, the Primary Fund announced on February 26, 2009, a "Plan of Liquidation" that would withhold $3.5 billion from distribution to investors who have not yet been fully paid for redeemed shares in the Primary Fund. (Declaration of Michael J. Osnato, Jr., executed May 4, 2009 ("Osnato Decl."), Ex. 1.) In accord with the plain language of Section 25(c), the instant action seeks, among other relief, an order enjoining the consummation of the Fund's proposed plan because it is neither fair nor equitable to investors.

II. THE COMMISSION MAY SEEK, AND THE COURT SHOULD APPROVE, A PLAN OF DISTRIBUTION THAT GIVES EACH SHAREHOLDER A *PRO RATA* SHARE OF THE *RES*.

The Commission may seek, and the Court should approve, the Plan of distribution sought by the Commission under Section 21(d)(5) of the Securities Exchange Act of 1934, which provides that "[i]n any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors." 15 U.S.C. §

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[5] Under Section 2(a)(33)(E) of the Investment Company Act, the Fund's announced plan of distribution qualifies as a "plan of reorganization," which is defined as "a voluntary dissolution or liquidation of a company." 15 U.S.C. § 80a-2(a)(33)(E).

78u(d)(5). Courts in and out of this Circuit routinely exercise their equitable authority to compel specific distribution plans in similar contexts.[6]

Well before the enactment of Section 21(d)(5) as part of the Sarbanes-Oxley Act of 2002, the district courts' general equitable power to fashion appropriate relief in securities law cases was firmly established. See SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1103 (2d Cir. 1972) (holding that even when the federal securities laws do not specifically authorize a certain form of relief, "it is for the federal courts to adjust their remedies so as to grant the necessary relief where federally secured rights are invaded."). Both prior to and after the enactment of Section 21(d)(5), district courts routinely have exercised their equity jurisdiction to fashion relief in securities cases, particularly with respect to protecting assets for distribution to investors. See, e.g., Eberhard v. Marcu, 530 F.3d 122, 131 (2d Cir. 2008) ("Although neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 explicitly vests district courts with the power to appoint trustees or receivers, courts have consistently held that such power exists.") (quoting SEC v. American Bd. of Trade, Inc., 830 F.2d 431, 436 (2d Cir. 1987)); Liberte Capital Group, LLC v. Capwill, 462 F.3d 543, 552 (6th Cir. 2006) (district court has authority to enjoin non-parties from instituting suits against assets subject to a receivership); SEC v. Wencke, 622 F.2d 1363, 1365 (9th Cir. 1980) (district court can issue stay prohibiting commencement of any suit against receivership entities except by leave of the court); SEC v. Byers, 592 F. Supp. 2d 532,

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6 Banc of America Securities does not dispute the Court's equitable powers under Section 21(d)(5); rather, it asserts that Section 25(c) does not give the Commission the right to force an inequitable reorganization plan or substitute its judgment for the Court's. (Banc of America Obj. (Birnbaum Decl. Ex. 3) at 2.) But it is the Court, and not the Commission, that will reach a decision on the distribution after considering all objections and responses. Moreover, even if Section 25(c) does not contemplate the proposal of a plan by the Commission, in practical terms, the statute produces this result; the Commission will invoke Section 25(c) to seek an injunction against any plan other than one that distributes the Fund's assets *pro rata* on the grounds that any alternative plan – as we explain below – would be unfair and inequitable.

536 (S.D.N.Y. 2008) (district court has authority to enjoin non-parties from filing involuntary bankruptcy petitions against receivership entities).

Moreover, where, as here, there are limited assets to satisfy multiple competing claimants, courts routinely defer to the Commission's "experience and expertise" in determining how to distribute funds, and, pursuant to their general equitable powers, routinely review the Commission's distribution plans to ensure that they are "fair and reasonable." See, e.g., Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC, 467 F.3d 73, 82-83 (2d Cir. 2006); SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991).[7]

In WorldCom, the Commission filed a civil enforcement action alleging accounting fraud and seeking injunctive relief and civil monetary penalties against WorldCom, which subsequently filed for Chapter 11 bankruptcy protection. WorldCom, 467 F.3d at 75-76. Under the plan of distribution proposed by the Commission in its civil action against WorldCom, funds from the bankruptcy estate were to be used to pay investors. Id. at 76. Applying a standard of "fair and reasonable" to the Commission's proposed settlement and plan, the district court approved the plan even though it provided for compensation to investors who otherwise would have recovered nothing in the related bankruptcy proceeding. Id. (approving usage of the Fair Funds for Investors provisions of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7246(a)). In an appeal taken by WorldCom's unsecured creditors, the Second Circuit upheld the district court's

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7 The Commission's authority to propose a plan of distribution and the Court's authority to approve the Commission's plan do not turn on the Commission's success on its underlying claims against wrongdoers, or the Commission's control over the assets in the Fund. No one challenges the propriety of distributing the Fund's available assets to shareholders, or that shareholders' rights to those assets are superior to any that Defendants or the Fund might claim (except for limited contractual rights).

"fair and reasonable" standard of review and held that it did not abuse its discretion in approving the plan. Id. at 81.

Additional sources of authority for the *pro rata* distribution of Fund assets abound. In the myriad cases where the Commission has filed a civil enforcement action and a receiver has been appointed to, among other things, marshal and distribute receivership assets to investors, courts have exercised their broad equitable discretion to approve *pro rata* distribution plans. See, e.g., SEC v. Credit Bancorp, Ltd., 290 F.3d 80, 85 (2d Cir. 2002) (upholding plan where receiver would liquidate all assets, including shares of stock transferred by one defrauded victim, and distribute the resulting cash on a *pro rata* basis to all victims, based on the amounts of their initial investments); SEC v. Infinity Group Co., 226 F. App'x 217, 219 (3d Cir. 2007) (upholding use of *pro rata* distribution in "ponzi" scheme involving many innocent investors, even when it was possible to trace assets to a particular investor; district court did not err in concluding that there was no equitable basis to distinguish between investors); SEC v. Forex Asset Mgmt. LLC, 242 F.3d 325, 331 (5th Cir. 2001) (no abuse of discretion in pooling all assets for *pro rata* distribution, even if some investors could trace their investments); United States v. Durham, 86 F.3d 70, 72-73 (5th Cir. 1996) (affirming use of *pro rata* distribution plan, even when certain claimants could trace their investments, when all claimants "stand equal in terms of being victimized"). General equitable principles further hold that claimants usually share ratably in fund assets. See 3 Ralph Ewing Clark, A Treatise on the Law and Practice of Receivers § 667.4 at 1213 (3d ed. 1992) ("The maxim, equality is equity, is frequently applied by courts of equity in the distribution of assets and funds in their hands" and courts "pay over funds in their hands equitably and ratably among claimants without regard to the character of their claims . . . .").

In short, there is clear and settled statutory and case authority for the relief sought by the Commission.

III. ANY PLAN THAT WOULD DRAW DISTINCTIONS AMONG INVESTORS BASED UPON ALLEGED CONTRACTUAL RIGHTS ARISING OUT OF CONFIRMATIONS OF REDEMPTION WOULD BE UNFAIR AND INEQUITABLE.

The vast majority of Objectors do not question the Court's jurisdiction and authority to act upon the Commission's proposed relief, and choose instead to propose their own plan – one that recognizes what those Objectors believe are their "contractual rights." (See, e.g., CSAFE Obj. (DE 48) at 3; Deutsche Bank Obj. (DE 68) at 7-8; VeriSign Obj. (Birnbaum Decl. Ex. 1) at 8-9.) As several Objectors note, on September 15, and for part of September 16, many shareholders received "confirmations" that their redemption requests had been received and would be paid out at $1 per share, the next per-share NAV announced by the Fund at that time. But, because the prospectus, not the confirmations, set shareholders' contractual rights, all unpaid shareholders stand in the same shoes vis-à-vis their contract rights. While the confirmations ordinarily offer good evidence of what investors are entitled to, here, the confirmations do not govern because they reflect an unreliable NAV. The confirmations should not, therefore, give certain shareholders special rights to a greater share of the Fund's assets than other shareholders.

A. The Contractual Relationship Between the Fund and Shareholders Springs from the Contract, Not Confirmations, Which Were Based Upon an Inaccurate and Misinformed NAV.

All of the Objectors who base their claims on confirmations start from the premise that the confirmations they received entitle them to the NAVs recorded there. But the Prospectus, which undeniably governs the investors' contractual relationship, provides that shares "will be

redeemed at the next NAV determined after a proper redemption request." (Osnato Decl. Ex. 2.). While confirmations ordinarily document what the next determined NAV for the Fund was at any given time, because the NAVs set throughout the day on September 15 and through 3 p.m. on September 16 were the product of a process infected by misinformation, those NAVs are not meaningful here. (See Memorandum in Support of the Commission's Application ("Application Memorandum," or "Appl. Mem.") at 9-11.)

Under these circumstances, the approach embraced by the court in SEC v. Alpine Mut. Fund Trust, 824 F. Supp. 987 (D. Colo. 1993), in the face of similar contract claims based on confirmations, is instructive. There, the Court rejected the claims of redeemers at the NAVs appearing on their confirmations, agreeing with the court-appointed receiver that the stated NAVs were grossly inaccurate and did not reflect the fair market value of the Funds' assets. Id. at 991. Notwithstanding what appeared on the confirmations, the Court approved a restatement of the NAVs, even though it would "*equitably* reduce amounts that were incorrectly reported . . . as [the] proper redemption" figures. Id. at 993 (emphasis in original).[8]

As described in the Application Memorandum, restating the Fund's NAV would not be possible in this case. (Appl. Mem. at 7-16.)[9] At the same time, the stated NAV should not be

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8 In that case, the receiver agreed with the pre-receivership redeemers that they should be treated as "creditors." Id. at 992. Accordingly, the Alpine court did not determine the issue and any language about their status is therefore *dicta*. As the Commission argues below, *all* Unpaid Shareholders here are creditors.

9 The Commission maintains that it would be impossible to recalculate the Fund's NAV because the Trustees had numerous options available to them had they been apprised of all of the facts through the day on the 15th, including what the market was bidding for Lehman, the unprecedented levels of redemptions and State Street's refusal to extend the Fund's overdraft privileges, and the true facts concerning RMCI's commitment to protect the Fund's NAV. While the Trustees may have valued Lehman at zero, striking a different NAV, they might also have sought to suspend striking an hourly NAV or redemptions altogether, among other actions they could have considered and moved to implement. (Appl. Mem. at 15-16; accord Henry Ford

recognized, where, as in Alpine, and the exceptional circumstances presented in this case, it was not appropriately "determined." Indeed, because the Fund is only the second money market fund to break the buck, there can be no fear that the Commission's Plan will wreak havoc on investor confidence, as Objector E*TRADE grimly predicts. (E*TRADE Obj. (DE 76) at 11-12.) A *pro rata* distribution here would be recognized as a fair and pragmatic response to a highly unusual situation, not a fundamental reshaping of the financial order. Although a board's business judgment is entitled to deference, in this case, the Trustees effectively were disabled from exercising reasonable business judgment. In exceptional circumstances such as these, when the process by which the NAV was struck was so impaired by misinformation and lack of information that even the Trustees would not defend their decisions as reasonably informed business judgments, this Court may properly exercise its equitable authority to reach a fair and equitable result, contract claims notwithstanding.

Indeed, many Objectors implicitly agree that the confirmations' printed value was not necessarily accurate and is therefore entitled to no weight. As the Fund admitted in its November 26, 2008 press release (Osnato Decl. Ex. 13), it issued $1 confirmations to scores of investors on September 16 *after* the Fund broke the buck. In noting that they submitted their redemptions prior to 11 a.m. (the time the Fund has now set as the time when its NAV dipped below $1), several Objectors argue that their confirmations are superior to those $1 confirmations issued after that time. (See, e.g., Wal-Mart Obj. (DE 57) at 1-2; Cellco Obj. (DE

Health Systems Memorandum in Support (DE 131) at 18 -19; Northern Trust Obj. (DE 85) at 9-10.) Any one of those actions, moreover, would have greatly and almost immediately triggered an even more substantial run on the Fund and put the Fund into liquidation mode.

79) at 4-5, 12, J.M. Huber Obj. (DE 81) at 8-9.)[10] These Objectors seem to agree that an error in computing the Fund's NAV would not create a "contractual right" to $1 per share any more than a typographical error confirming a $2.00 per-share NAV would entitle redeeming shareholders to $2.00 per share.

In short, because the Fund's investors' contract rights are set by the Prospectus, which gave all investors the right to a "determined" NAV, investors should not be permitted to rely upon a confirmation that essentially reflects an error committed by the entity or individual calculating the NAV, especially when that error resulted from a fundamental breakdown in the process of determining the Fund's NAV.

B. Investors' Status as "Creditors" Does Not Create Any Special Right to Fund Assets.

Certain early redeemers also maintain that their rights are superior to later redeemers and non-redeemers because, once they received their confirmations, they became "unsecured creditor[s], as opposed to shareholders." (See, e.g., E*TRADE Obj. (DE 76) at 11; Russell Invest. Obj. (DE 24) at 11-12.) This argument ignores, however, that all Fund investors are creditors of the Fund, whether they redeemed or not.

Investors in an investment company have contractual rights to redemption *not* enjoyed by shareholders in an ordinary stock corporation. In re Bayou Group, LLC, 372 B.R. 661, 665 (Bankr. S.D.N.Y. 2007) (given the contractual right of redemption, shareholder in bankrupt

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10 Several Objectors draw a line at 11:00 a.m. on September 16 because that is the time of the NAV strike identified in RMCI's November 26, 2008 press release announcing the "administrative error" in valuing the Fund. (See, e.g., FPL Group Obj. (Birnbaum Decl. Ex. 7), at 2.) 11:00 a.m. was the "next NAV determined" for all redemptions properly requested after 10:00 a.m., the time at which the Primary Fund was last scheduled to strike an NAV before 11:00. Thus, to the extent that RMCI's administrative error identifies any line of demarcation distinguishing among redemption requests, that line appears to be 10:00 a.m, not 11:00 a.m., leaving Objectors like FPL Group with a dollar confirm that could be honored at, at most, $0.99.

hedge fund is a creditor like any other contract claimant). Therefore all shareholders in an investment company are both equity holders and creditors.

Furthermore, even if the early redeemers could argue for return of their investment because they received confirmations with a greater NAV value, the equitable principle that all claims should be considered in parity, with no claimant being preferred over another, should not be displaced by any other theory of recovery. See WorldCom, 467 F.3d at 85; Clark, supra, § 667 at 1199 ("[A] court of equity is not bound by insolvency or bankruptcy statutes of distribution and preference.").

IV. THERE IS NO PRINCIPLED WAY TO DISTINGUISH THE REDEMPTION CLAIMS OF EQUALLY BLAMELESS UNPAID SHAREHOLDERS.

The Commission's position that a *pro rata* distribution will best promote equity recognizes that there is no principled way fairly to distinguish the redemption claims of equally blameless shareholders, each having competing claims. While Objectors all contend that their particular shares should be redeemed at $1, those few Objectors that offer an alternative to the Commission's *pro rata* Plan cannot agree on which investors should bear the burden of a non-*pro rata* plan and receive less than $1 per share. (Compare, e.g., Safeco Obj. (DE 41) at 2-3 (advocating $1/share to all September 15 redeemers) with Toyota Obj. (Birnbaum Decl. Ex. 8 at 2-3 (advocating $1/share to all who redeemed prior to 11:00 a.m. on September 16.)) Even if they could agree, however, the Objectors' plans are all self-defeating because each would involve separate complicated factual inquiries that would simply consume the *Res* to virtually no one's benefit, and would serve to shift burdens among equally blameless shareholders.

A. The Veritable Morass of Conflicting Evidence Makes Classifications Unworkable and Unjust and Supports a *Pro Rata* Distribution.

Even assuming that there was a principled way to assign shareholders to classes that were deserving of differing NAVs (and there is not), the determination of which shareholders fall into which class would be rife with factual conflicts. For example, gaping differences between shareholder and Fund redemption records highlight that the priority of shareholder redemption requests is far from settled. Thus, any attempt to classify shareholders based on redemption priority would require a hearing for each redemption request. Moreover, assuming that priority could be established with any certainty, each determination of priority would alter the number of redeemed shares at any given time and trigger additional adjustments to the Fund's NAV.

A closer look at Cellco (Verizon) illustrates this point. According to the Fund's redemption records, Cellco redeemed 554,840,068 of its 620,040,068 shares at approximately 1:12 p.m. on September 16, *after* the Fund broke the buck. (See Osnato Decl. Ex. 6.) However, Cellco has submitted an email that reflects its redemption request of 554,840,068 Primary Fund shares by 9:10 a.m. on the morning of September 16, a critical four-hour time difference from the Fund's records. (Cellco Obj. (DE 79) at 4.) On the strength of this evidence, Cellco seeks to move up in the redemption queue, ahead of all post-9:10 a.m. redeemers on September 16.[11]

If the Court were to conclude that it should unravel the factual tangle regarding redemption priority as to Cellco and numerous other investors, the Court necessarily would also be undertaking to recalculate each strike of the NAV, as the number of redeemed shares at any

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[11] Cellco is only one of several Objectors who claim an earlier redemption time than that reflected on Fund records. (See ERCOT Obj. (Birnbaum Decl. Ex. 6 at 2 (describing September 16 redemption)) as compared to Osnato Decl. Ex. 6 (reflecting ERCOT's redemption as of September 25)); Northern Trust Obj. (DE 85) at 6 n. 2; Complaint of BNPP (DE 1 in 09-CV-05997) ¶¶ 22, 23, 27 (detailing BNPP's telephonic redemption requests at times earlier than those reflected on the Fund's redemption list.)

time directly impacts the Fund's contemporaneous NAV. If a significant volume of shares were assigned an earlier redemption time, the hour at which the Fund broke the buck would move back as well. Such an approach would be unworkable, given the number of factual disputes, and would unfairly disadvantage shareholders who do not have independent evidence of their redemption requests and must instead rely on the Fund's records.

Priority of redemption issues aside, the facts and circumstances surrounding the redemptions of certain shareholders are fraught with other complications. For example, certain investors assert that they would have redeemed their shares or that they would have declined to purchase additional shares on September 15 and early on September 16 but for Defendants' false assurances that the Fund would not break the buck. (See, e.g., First Data Obj. (Birnbaum Decl. Ex. 16) at 1.) If the Court were to decide to draw lines of classification based on which shareholders received and relied upon false assurances, the time and expense in added litigation would further dissipate the already limited Fund.

The importance of avoiding an endless spiral of costly and time consuming litigation cannot be overstated. This effort is not simply a matter of the Commission's desire to achieve simplicity for simplicity's sake. (See E*TRADE Obj. (DE 76) at 12.) To the contrary, the Commission recognizes the factual impossibility here of reconstructing an accurate NAV, and therefore seeks to place a *pro rata* share of assets in investors' hands in the most expeditious manner possible. As the Second Circuit observed in WorldCom, 467 F.3d at 84, "when funds are limited, hard choices must be made." In this case, the Court's "hard choice" arises from the profusion of claims, many of them credible, to a limited pool of assets. In the analogous context of "limited fund" class action litigation, the Supreme Court has noted that the very goal should be to ensure that a limited pool of assets is fairly allocated amongst many deserving claimants,

including by ensuring that scarce funds are not consumed by litigating individual claims. See Ortiz v. Fibreboard Corp., 527 U.S. 815, 838 (1999) (articulating concept of "limited fund" class action lawsuits, where courts must preserve sufficient funds to ensure equitable treatment of claimants).

B. The Commission's Plan Equally Distributes the Benefits and Burdens to All Unpaid Shareholders.

Several Objectors claim that a *pro rata* distribution would unfairly place the "entire burden of the Primary Fund's shortfall on the early redeemers ... without requiring any reductions to later redeemers' recovery." (See, e.g., Deutsche Bank Obj. (DE 68) at 9-10.) This argument improperly assumes as a premise its conclusion – that early redeemers are entitled to $1, and late redeemers are not. In fact, all unpaid shareholders should bear Lehman-related losses equally, and a *pro rata* distribution ensures that they do.

If the Board had set the value of the Fund's Lehman Holdings on the morning of September 15 at zero – the course it chose on September 16 when the Trustees finally became aware of all the salient facts – then the Fund's per-share NAV would have been approximately $0.987, or approximately the same amount that investors stand to recover under the Commission's proposed Plan. Each shareholder would have then received approximately 98.7 cents per share, plus a *pro rata* payment of any value the Fund may recoup for its Lehman Holdings.

An examination of how a non *pro-rata* plan impacts "later redeemers" crystallizes the unfairness of a distribution that pays some Unpaid Shareholders more than others. Simple math dictates that every dollar paid to a shareholder leaves fewer dollars available to pay other unpaid shareholders. Thus, if all shareholders who hold $1 confirmations are paid a full $1 per share out

of the assets remaining in the Fund – a group that appears to comprise more than half of the remaining unpaid shareholders (see Osnato Decl. Ex. 6) – the unpaid shareholders not holding $1 confirmations will receive, at most, approximately $0.97 for their shares. If, further, claimants who received $1 confirmations after 3:00 p.m. on September 16 in error were paid a full $1 per share, then the balance of unredeemed shareholders would receive even less per share.[12] Consequently, even though the Fund's Lehman Holdings, valued at par, amounted to little more than 1 percent of the Fund's total assets at the start of September 15, a plan that would offer some shareholders $1 while leaving a smaller pot of money for remaining shareholders to share will necessarily leave some investors to shoulder an extremely (and inequitably) disproportionate share of any Lehman-imposed burden.

A plan that rigidly credited the Board's uninformed NAV calculations would have the additional flaw of setting an arbitrary distinction between those investors that would benefit from a rounding of the Primary Fund's NAV and those who would not enjoy such a benefit. For example, early investors who redeemed when the Fund was worth $0.9951 per share (just above the minimum value that could permissibly be rounded to $1) would nonetheless receive $1 per share. In order to pay early redeemers the rounded-up value per share, money would essentially have been taken from later redeemers. While early redeemers would not have done anything improper, a fair and equitable plan of distribution should not force later redeemers to fund the rounded-up redemptions of earlier redeemers.

[12] Just how little some Unpaid Shareholders might ultimately receive for their shares would depend on how many claimants are awarded $1 per share, or at least more than a *pro rata* share of the Fund. Satisfaction of claims already asserted – with more sure to follow absent an injunction – may very well leave some investors with significantly less than $0.97 per share.

Objectors' assertions that a *pro rata* distribution would reward late redeemers over "conscientious and careful investors" who redeemed hours or even minutes earlier than other shareholders are not compelling. (See, e.g., E*TRADE Obj. (DE 76) at 11; Banc of America Obj. (Birnbaum Decl. Ex. 3) at 2.)[13] Nobody has claimed that the value of the Primary Fund's portfolio securities fluctuated in a way that justifies rewarding those investors who got their redemption requests in earliest. Whatever the Lehman Holdings were worth on September 15, a fair and equitable plan would compel all shareholders to share any Lehman-based loss in value to the Fund. The Fund's prospectus – the "contract" on which certain Objectors rely in shifting the Lehman-related losses to other shareholders – is a contract between the Fund and *all* investors, and there is no indication in the text of that contract that under circumstances such as those existing on September 15 and 16, some shareholders should be favored over others.

V. ENTRY OF RELIEF UNDER THE ALL-WRITS ACT IS NECESSARY AND APPROPRIATE IN AID OF THIS COURT'S JURISDICTION OVER THE *RES*.

Key to the Commission's Plan is the curtailment of indemnifiable claims against the Fund and its Trustees. By distributing the *Res*, the Court effectively would decide shareholders' and others' claims on the Fund, so to let other actions against the Fund continue would be to permit suits against a Fund with no assets, or, alternatively, would lead to the hold-back of a special reserve that could otherwise be distributed. The creation of such a reserve would defeat the primary purpose of the Commission's Plan – to fairly and equitably return Fund assets to investors as soon as reasonably practicable. Such a result could be avoided through an All-Writs

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[13] The Sixth Circuit recently noted that the focus in considering claims of priority in a ponzi scheme distribution should be on the "nature of the interest [held by the claimant], not on the degree of diligence spent to acquire it." Quilling v. Trade Partners, Inc., 572 F.3d 293, 300 (6th Cir. 2009).

Act injunction. Investors would not "lose out" from such an injunction; rather, an injunction ensures them a prompt *pro rata* distribution.

Certain Objectors question whether this Court may appropriately invoke its authority under the All-Writs Act, while others express concern about how such relief would impact non-indemnifiable claims against Defendants or other related entities and individuals. (See, e.g., E*TRADE Obj. (DE 76) at 6-7; Frankel Obj. (DE 62) at 3-7.) But as explained in the Commission's Application Memorandum, the Second Circuit has clearly ruled that All-Writs relief is particularly appropriate in cases such as this, where there are competing claims to a finite *res*. (Appl. Mem. at 23.)

Wal-Mart asserts: "To the extent that the SEC's proposed order in its *in personam* action against the Fund would enjoin earlier-filed actions in state court, it violates the [Anti-Injunction] Act." (Wal-Mart Obj. (DE 57) at 2.) This objection not only mischaracterizes the nature of this action – which is not *in personam*[14] – but is also incorrect as a legal matter. "If a court's 'injunction [is] in fact necessary in aid of its jurisdiction, then the injunction [is] authorized by the All Writs Act, and [is] not barred by the Anti-Injunction Act.'" SR Int'l Bus. Ins. Co., 445 F. Supp. 2d at 360 n.5 (quoting Retirement Sys. of Ala. v. J.P. Morgan Chase & Co., 386 F.3d 419, 425 (2d Cir. 2004)).

E*TRADE's attempt to distinguish the salient facts in this action from In re Baldwin United Corp., 770 F.2d 328 also is unavailing. (E*TRADE Obj. (DE 76) at 6-7). If this Court

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[14] See Judge Mukasey's discussion distinguishing *in rem* and *quasi-in rem* cases for which All-Writs relief is appropriate from true *in personam* actions ill-suited for such relief. SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., LLC, 445 F. Supp. 2d 356, 360 (S.D.N.Y. 2006); see also In re Baldwin United Corp., 770 F.2d 328, 337 (2d Cir. 1985) ("[T]he jurisdiction of a multidistrict court is 'analogous to that of a court in an in rem action or in a school desegregation case, where it is intolerable to have conflicting orders from different courts.'" (citation omitted)).

grants the Commission's application to enjoin the Fund's plan of distribution, the Court will have unambiguously exercised its jurisdiction over the *Res* here at issue. "[B]ecause the 'exercise by the state court of jurisdiction over the same res necessarily impairs, and may defeat, the jurisdiction of the federal court already attached,' the federal court is empowered to enjoin any state court proceeding affecting that res." Id. at 336 (quoting Kline v. Burke Constr. Co., 260 U.S. 226, 229 (1922)).

The Commission is not simply seeking an All-Writs Act injunction to avoid duplicative litigation, although that is one valid purpose such an injunction would serve. Rather, as in Baldwin, an All-Writs Act injunction is necessary here to effectuate the underlying relief the Commission seeks through a *pro rata* distribution plan. To enjoin the Fund's proposed plan of distribution while allowing cases against the Fund to proceed in various state and federal courts would defeat the purpose of the Commission's action, as the Trustees would presumably create a new "Special Reserve" while claimants race to perfect judgment against the Fund and others pursue claims against those whom the Fund must indemnify. Allowing claims against individuals or entities that are not entitled to indemnification from the Fund (either because of the nature of the claims asserted or the absence of any indemnification agreement covering certain defendants) does not pose the same threat to the fair and equitable distribution of Fund assets. Accordingly, the Commission does not seek to enjoin any claims that will not give rise to a claim for indemnification from the Fund for liability.[15]

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[15] Several Objectors understandably question why late redeemers should be permitted to pursue fraud claims that may bring them a greater total recovery than early redeemers. (See, e.g., J.M. Huber Obj. (DE 81) at 11.) The Commission did not intend to create an ability to recover for late redeemers to the possible detriment of other investors. Accordingly, and as set forth in the Appendix, the Commission hereby clarifies its Plan to require a *pro rata* distribution of any funds awarded to any investor in satisfaction of any claim for relief relating to the facts

VI. THE COMMISSION'S PLAN SEEKS TO ACCOMODATE PROPOSALS MADE BY SHAREHOLDERS THAT ARE CONSISTENT WITH THE PLAN'S OBJECTIVE OF FAIRNESS, EQUITY AND FINALITY.

Many investors' submissions do not object to a *pro rata* distribution of funds, but seek clarification of certain aspects of the Plan or propose additional features to be added to the Plan. Where those suggestions are not inconsistent with the initial *pro rata* Plan set forth by the Commission and do not unfairly compromise any individual's or entity's rights, the Commission seeks to include those proposals in the Amended Term Sheet attached hereto as an Appendix. A brief overview of the most pertinent modifications or clarifications is set out below.

A. Purchasers at Less than $0.97

The Commission did not intend for its Plan to create a windfall for investors who purchased shares of the Primary Fund for less than the amount they would receive in a *pro rata* distribution. Accordingly, all investors redeeming shares purchased for an amount less than that which this Court may determine shall be distributed to investors *pro rata* should be receive no more than the purchase price for those shares.

B. Possible Recovery of "Overpayments" to Paid Redeemers

Several investors object to the absence in the Plan of any mechanism to claw back payouts made on September 15 to certain "early" redeemers who received a full $1 per share (the "Fully Paid Redeemers"). Essentially, these objections all offer some variant of the argument that if the Court chooses not to credit the Trustees' misinformed NAV calculations on September 15 in determining how to allocate funds among Unpaid Shareholders, then the same NAV should

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underlying the instant action. This clarification should not compromise the rights of any fraud claimant because, should the Plan be approved, fraud claimants will get no less than any other claimant. (<u>See</u> <u>also</u> Henry Ford Health Systems (DE 131) at 23 (sharing recovery on non-indemnifiable claims is appropriate because all investors are victims of fraud).)

not be credited to support actual $1 per share payments to the earliest of redeeming shareholders. (See, e.g., Unpaid Timely Redeemer Group Obj. (DE 64) at 12-15; TD Ameritrade Obj, (DE 70) at 18.)[16] These Objectors' appeal for what amounts to a *pro rata* distribution to *all* investors who held shares on September 15 is bolstered by Fund records that indicate that certain shareholders on September 15 were paid out of order – that some redemptions were apparently funded in an order other than that in which redemptions were received. (Osnato Decl. Ex. 6 (shaded entries indicating paid out investors).)

The Commission understands Objectors' desire to investigate the circumstances under which certain redeemers were fully paid on September 15. Therefore, the Commission would not object if the Court were to charge the proposed Monitor with investigating such claims and imbue the Monitor with the sole discretion to pursue any such claims he deems appropriate, as a receiver, with counsel retained on a contingent fee basis.

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[16] A group of investors calling themselves the "Unpaid Timely Redeemer Group," which together redeemed more than 8 billion shares in the Primary Fund, further requests that the Court require that certain investors who received $1 for some, but not all, of their redeemed shares – a group the Unpaid Timely Redeemer Group calls "Straddlers" – be compelled to forego part of any *pro rata* payment sufficient to "offset the excess portion of $1 NAV distributions on September 15" that those Straddlers received. (Unpaid Timely Redeemer Group Obj. (DE 64) at 14-16.) The Commission understands this suggestion to be substantively the same as the Unpaid Timely Redeemer Group's request, also articulated by certain other Objectors, that all funds paid to fully redeemed shareholders be "clawed back" so that investors who held shares at the start of September 15 share any losses equally.

C. Future Expenses

If approved, the Plan will necessarily impose some unavoidable costs on the Fund in connection with its liquidation and its existing contractual obligations to pay litigation expenses of indemnified parties incurred in the successful defense of non-indemnifiable claims. To ensure that the Fund assets are distributed as efficiently as possible, the Commission recognizes the need to both quantify and limit those expenses and has proposed a mechanism and schedule to address those concerns. The categories of expenses are: (1) management fees and expenses claimed by the Fund's adviser, Defendant RMCI, and the Fund's distributor, Defendant Resrv Partners, as owing under their respective contracts with the Fund; (2) indemnification expenses for litigation costs associated with the successful defense of claims asserting non-indemnifiable conduct against the Fund and its indemnitees, and State Street Bank and Trust, the Fund's custodian and agent; and (3) the costs and expenses of the Monitor. The Plan proposes that an Expense Fund be set at $75 million, now, so that the remaining assets in the Fund can be distributed as soon as possible.

To ensure that all indemnitees have a chance to be heard, and that the Fund's remaining assets can be distributed quickly, the Plan also proposes a mechanism for a final adjudication of an appropriate amount to be withheld as the Expense Fund from distribution. For the litigation expenses payable pursuant to the Fund's various indemnification agreements, the proposed Plan provides that the Court set a bar date for the assertion of all non-indemnifiable claims, and provides that 15 days after such bar date, the indemnitees will submit good faith estimates of their respective reasonable litigation expenses as a result of their defense of such claims. The Monitor will then recommend to the Court which claims should be honored and the Court will

determine whether to accept the Monitor's recommendation and direct him or her to set aside such amounts sufficient to satisfy those obligations.

As to the Defendants RMCI and Resrv Partners' claim for management fees and expenses under their contracts with the Fund, the Plan proposes that RMCI and Resrv Partners be directed to submit their claims within 45 days after the Plan is approved. The Monitor thereafter would recommend what portion of their claims are due and payable, leaving the determination of the final payment to the Court's determination. Any claim by the Commission in its action against the Defendants for disgorgement of fees paid to RMCI or Resrv Partners would be preserved, and the Commission would distribute any disgorged amounts *pro rata* to Unpaid Shareholders as permitted by the securities laws.

D. Distribution of Any Recoveries in the Commission's Action Against Defendants

The Plan contemplates that any recoveries obtained by the Commission in its action against Defendants RMCI, Resrv Partners and the Bents, such as disgorgement and penalties, will be distributed *pro rata* to Unpaid Shareholders to the extent allowable under the securities laws.

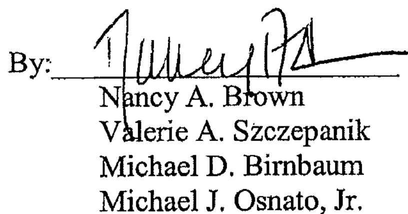
CONCLUSION

For the reasons stated herein, the Commission respectfully requests that this Court enjoin the Primary Fund's unfair and inequitable plan of distribution and approve the Commission's proposed Plan, subject to the terms and conditions set forth in the Appendix.

Dated: New York, New York
August 21, 2009

Respectfully submitted,

SECURITIES AND EXCHANGE COMMISSION

By: 

Nancy A. Brown
Valerie A. Szczepanik
Michael D. Birnbaum
Michael J. Osnato, Jr.

New York Regional Office
3 World Financial Center
New York, New York 10281
Tel: (212) 336-1100
Attorneys for Plaintiff

TAB B

Appendix

The Commission's Amended Term Sheet

The Commission submits this Amended Term Sheet in order to clarify those terms presented in the Commission's Term Sheet circulated to Claimants and record holders of the Primary Fund and appended as an Appendix to the Court's June 8, 2009 Order.

As more fully explained in the Commission's Memorandum of Law in Response to Objections, submitted herewith, the Commission now has included certain provisions because they were requested by certain Claimants and because the Commission believes that those provisions are consistent with the previously proposed terms. Therefore, the Commission does not object to their inclusion in any final order issued by the Court.

Monitor's Duties

1. Appointment of a Monitor, proposed by the Commission and approved by the Court, with responsibility for:

a. liquidation and distribution of the assets of The Reserve Primary Fund ("Primary Fund");

b. investigation of grounds to claw back payouts by the Primary Fund at any time after 8:00 a.m. on September 15, 2008 in excess of amounts to be paid under this Plan to Primary Fund Shareholders who have not received $1.00 per share owned on or after September 15, 2008 ("Unpaid Shareholders");

c. ensuring that Unpaid Shareholders who bought Primary Fund shares after 3 p.m. on September 16, 2009 receive no more than the amount paid by such Unpaid Shareholder for each such share purchased;

d. investigation of the circumstances surrounding the transfers after 8:00 a.m. on September 15, 2008 by Primary Fund shareholders to other Funds advised by RMCI; and

e. review of any claims by the Primary Fund's adviser or distributor for management fees and expenses associated with the Primary Fund, and review of any claims for indemnification, as set forth herein.

2. In connection with the duties of investigation set forth in Paragraphs 1(b) and (d) above, and within 90 days of his appointment, the Monitor, in his or her sole discretion, shall determine those claims that should be pursued in the best interests of all Unpaid Shareholders, and shall recommend to the Court that he or she be appointed as receiver for the limited purpose of pursuing such claims (the "Claw Back Claims") on a contingency basis. Any net recovery obtained by settlement or judgment on such Claw Back Claims shall be distributed *pro rata* to Unpaid Shareholders, except that Unpaid Shareholders shall not receive a greater per-share total recovery than any shareholder from whom money is clawed back. The Commission reserves the right to object to any Claw Back Claim asserted if it believes such claim would be inconsistent with the equitable treatment of all current and former shareholders of the Primary Fund.

3. The Monitor shall promptly effect a distribution of the assets of the Fund, less the Expense Fund and Monitor Fund, as defined below, to the Unpaid Shareholders on a *pro rata* basis per share, and shall make all reasonable efforts to begin distribution within 30 days of the Monitor's appointment by the Court.

Initial Holdback for Certain Expenses

4. Excluded initially from the distribution of Primary Fund assets described herein shall be a fund of $75 million ("Expense Fund"), set aside to pay for:

a. the "Indemnification Expenses," which shall include:

(i) reasonable litigation expenses that may be incurred by State Street Bank and Trust Company ("State Street"), and indemnifiable by the Primary Fund pursuant to Section 15 of the Master Custodian Agreement, dated March 7, 2008, between, *inter alia*, the Primary Fund and State Street (the "State Street Indemnifiable Expenses"); and

(ii) reasonable litigation expenses that may be incurred by any "Indemnitee" as defined in the SEVENTH Declaration, Paragraph 11, of the Amendment Number Two to, and Restatement of, The Declaration of Trust, made December 10, 1986 of The Reserve Fund (the "Declaration of Trust"), and to the extent payable pursuant to the terms of the SEVENTH Declaration, Paragraph 11 (the "Declaration of Trust Indemnifiable Expenses"); and

b. any claims by the Primary Fund's adviser or distributor for management fees and expenses associated with the Primary Fund that are determined to be due and payable.

5. The Primary Fund shall make available proceeds from any applicable insurance policies to reimburse Indemnification Expenses. Such insurance proceeds shall be exhausted before any monies are advanced from the Expense Fund.

6. Also excluded initially from the distribution of Primary Fund assets described herein shall be a fund of $2 million ("Monitor Fund"), set aside to pay for the reasonable costs, fees and expenses of the Monitor (the "Monitor Fees"). All Monitor Fee applications shall be made by application to the Court setting forth in reasonable detail the nature of such costs, fees and expenses.

Claims against the Expense Fund[1]

7. Any and all claims by the Primary Fund's adviser or distributor for management fees and expenses associated with the Primary Fund must be brought within 45 days of the entry of the order of the Court approving a plan of distribution ("Claims Deadline"), or they will be forever barred. These claims shall be reviewed by the Monitor, who will make a recommendation to the Court concerning whether the claims are due and payable. The Court will then finally determine the amounts due and payable on such claims, if any, and direct the Monitor to make payment from the Expense Fund. Nothing herein shall limit the Commission's right to seek to recover any amounts paid to the Primary Fund's adviser or distributor in connection with its pending action against those entities.

8. On or before 15 days following the Claims Deadline, any claimant for indemnity, including State Street and all Indemnitees, must provide the Monitor with good faith estimates of their respective reasonable litigation expenses. The Monitor will review whether those expenses are indemnifiable and, upon consideration of all claims for indemnification, shall make a recommendation to the Court as to which claims should be honored. The Court will finally determine which claims should be honored and direct the Monitor to set aside in the Expense Fund amounts sufficient to satisfy those obligations.

9. At the appropriate time, the Monitor shall distribute to Unpaid Shareholders all amounts in the Expense Fund in excess of the amounts determined by

[1] For the purposes of this Term Sheet, any reference to "claims" or "claimants" shall not include state securities regulators.

the Court to satisfy claims for indemnification, and all amounts in the Monitor Fund in excess of the Monitor's costs, fees and expenses.

Enjoined Claims

10. All claims, whether actual or contingent, matured or unmatured, asserted or unasserted, directly or indirectly, against the Primary Fund or any person or entity entitled to be indemnified by the Primary Fund, but only to the extent of the Primary Fund's obligation to indemnify, shall be enjoined by Order of this Court, including, without limitation, all shareholder claims against any of the Defendants or the Relief Defendant, and their respective officers, directors, trustees, representatives, agents or employees, that are subject to indemnification by the Primary Fund.

Bar Date for Other Claims

11. Any and all claims against individuals and entities, including Defendants, or any of their respective officers, directors, trustees, representatives, agents or employees, for conduct relating to the Primary Fund that results from any such individual's or entity's willful misfeasance, bad faith, or gross negligence, in the performance of their duties, or by reason of his reckless disregard of their obligations and duties ("Non-Indemnifiable Conduct") must be brought by the Claims Deadline, or they will be forever barred.

Miscellaneous

12. If the Commission is successful in recovering any amounts in an award of disgorgement (including fees paid to the Defendants by the Primary Fund since September 15, 2008) or penalties from Defendants in this action, it will turn over such recovery to the Monitor for distribution, to the extent it is permitted to do so under the Fair Fund provisions of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7246.

13. Any Unpaid Shareholder who pursues claims against Defendants, or any of their respective officers, directors, trustees, representatives, agents or employees, for Non-Indemnifiable Conduct, and who recovers an amount in excess of his *pro rata* share distributed pursuant to this Plan, shall turn over such excess recoveries to the Monitor for distribution to all Unpaid Shareholders on a *pro rata* basis.

TAB C

SECURITIES AND EXCHANGE COMMISSION
Attorneys for Plaintiff
New York Regional Office
3 World Financial Center, Room 430
New York, NY 10281
(212) 336-1100
(212) 336-1323 (fax)

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, **Plaintiff,** **v.** **RESERVE MANAGEMENT COMPANY, INC., RESRV PARTNERS, INC., BRUCE BENT SR. and BRUCE BENT II,** **Defendants,** **and** **THE RESERVE PRIMARY FUND,** **Relief Defendant.**	**No. 09 Civ. 4346 (PGG)** **ECF CASE**

DECLARATION OF MICHAEL D. BIRNBAUM IN SUPPORT OF PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S APPLICATION FOR INJUNCTIVE AND OTHER RELIEF AND APPROVAL OF THE COMMISSION'S PROPOSED PLAN OF DISTRIBUTION

I, Michael D. Birnbaum, pursuant to 28 U.S.C. § 1746, declare as follows:

1. I am over 18 years of age and am employed as an attorney in the Enforcement Division in the New York Regional Office of the Securities and Exchange Commission ("Commission"). I submit this Declaration in support of the Commission's Application for Injunctive and Other Relief and Approval of the Commission's Proposed Plan of Distribution (the "Application").

2. I submit this Declaration based upon personal knowledge, information and belief.

3. Attached hereto as Exhibit 1 is a true and correct copy of VeriSign, Inc.'s Objection to the Proposed Plan of Distribution of Primary Fund Assets, dated July 27, 2009 and attachments thereto.

4. Attached hereto as Exhibit 2 is a true and correct copy of the Response of BNP Paribas Securities Corporation and BNP Paribas Commodities Futures, Inc. to SEC's Motion Regarding Distribution of Reserve Primary Fund Assets, dated July 27, 2009.

5. Attached hereto as Exhibit 3 is a true and correct copy of Banc of America Securities LLC's July 27, 2009 submission to this Court concerning the Commission's Application.

6. Attached hereto as Exhibit 4 is a true and correct copy of a joint submission to this Court, from The Goodyear Tire & Rubber Company, The Lubrizol Corporation, Delta Air Lines, Inc., and General Mills, Inc., dated July 21, 2009, concerning the Commission's Application.

7. Attached hereto as Exhibit 5 is a true and correct copy of BP Corporation North America Inc.'s submission to this Court, dated July 24, 2009, concerning the Commission's Application.

8. Attached hereto as Exhibit 6 is a true and correct copy of The Electric Reliability Council of Texas, Inc.'s submission to this Court, dated July 27, 2009, concerning the Commission's Application.

9. Attached hereto as Exhibit 7 is a true and correct copy of FPL Group

Capital, Inc.'s submission to this Court, dated July 23, 2009, concerning the Commission's Application.

10. Attached hereto as Exhibit 8 is a true and correct copy of Toyota Motor Credit Corporation's submission to this Court, dated July 22, 2009, concerning the Commission's Application.

11. Attached hereto as Exhibit 9 is a true and correct copy of David Lerner Associates, Inc's submission to this Court, dated July 22, 2009, concerning the Commission's Application.

12. Attached hereto as Exhibit 10 is a true and correct copy of Arthur J. Levy's submission to this Court, dated July 20, 2009, concerning the Commission's Application (redacted to comply with Fed. R. Civ. P. 5.2 and this Court's ECF Rules).

13. Attached hereto as Exhibit 11 is a true and correct copy of Norton Capital Management, Inc.'s submission to this Court, dated July 21, 2009, concerning the Commission's Application.

14. Attached hereto as Exhibit 12 is a true and correct copy of Newedge USA, LLC's letter to Commission counsel, dated July 17, 2009, concerning the Commission's Application.

15. Attached hereto as Exhibit 13 are true and correct copies of Union Center National Bank's two submissions to the Court, dated July 14, 2009 and July 16, 2009 respectively, concerning the Commission's Application.

16. Attached hereto as Exhibit 14 is a true and correct copy of Kevin Cullinane's letter to Commission counsel, dated July 5, 2009, concerning the Commission's Application (redacted to comply with Fed. R. Civ. P. 5.2 and this Court's

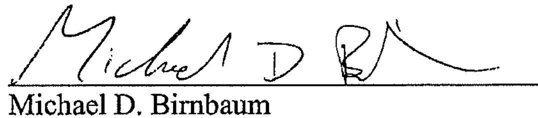
ECF Rules).

17. Attached hereto as Exhibit 15 is a true and correct copy of George Swift's letter to Commission counsel, dated June 26, 2009, concerning the Commission's Application (redacted to comply with Fed. R. Civ. P. 5.2 and this Court's ECF Rules).

18. Attached hereto as Exhibit 16 is a true and correct copy of First Data Corporation and Integrated Payment Systems, Inc.'s submission to this Court, dated July 27, 2009, concerning the Commission's Application.

I declare under penalty of perjury that the foregoing is true and correct.

Executed: August 21, 2009
New York, New York



Michael D. Birnbaum