IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	Civil Action No. 3:09-CV-0298-N
	§	
STANFORD INTERNATIONAL BANK, LTD., *et al.*,	§	
	§	
Defendants.	§	

BRIEF IN SUPPORT OF MOTION FOR RELIEF FROM THE INJUNCTION CONTAINED IN PARAGRAPH 10(e) OF THE RECEIVERSHIP ORDER AND REQUEST FOR EXPEDITED HEARING

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PRELIMINARY STATEMENT

The undersigned counsel represent hundreds of individuals and entities who hold Certificates of Deposit ("CDs") issued by, and/or who have funds on deposit at, Stanford International Bank, Ltd. ("SIBL"), and who suffered staggering losses as a result of the Defendants'[1] purported operation of one of the largest "Ponzi" schemes in history. By this Motion, the Movants[2] urgently request that this Court lift the injunction contained in paragraph 10(e) of the Receivership Order,[3] which, among other things, prohibits the filing of an involuntary bankruptcy petition against any of the Defendants. The Movants also request an expedited hearing.

This is not the first time that the Movants have requested relief from this Court in an effort to have this case proceed under title 11 of the United States Code (the "Bankruptcy Code"), rather than under the *ad hoc* procedures of an equity receivership. On May 11, 2009, the Movants filed a motion with this Court (the "Intervention Motion")[4] seeking leave to intervene in this case, and for relief from the injunction contained in paragraph 11 of the Receivership Order, which, at the time, barred all parties for a period of 180 days from even seeking relief from the paragraph 10(e) injunction. The Court never ruled on the Movants' request to lift the paragraph 11 injunction, now rendering *that* request moot. However, now that the 180-day term of the paragraph 11 injunction has expired, this Motion seeking relief from the paragraph 10(e)

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[1] The "Defendants" means each of the defendants named in the above-captioned case: Stanford International Bank, Ltd., Stanford Group Company, Stanford Capital Management, LLC, R. Allen Stanford, James M. Davis, and Laura Pendergest-Holt.

[2] The "Movants" are Dr. Samuel Bukrinsky, Jaime Alexis Arroyo Bornstein, and Mario Gebel. The Movants are members of a group represented by the undersigned counsel but are, for the purposes of this Motion, acting in their individual capacities and on their own behalf.

[3] The "Receivership Order" refers to this Court's Order dated February 16, 2009, as amended March 12, 2009. [Apx. at pp. 45-56] The "Receiver" is Ralph Janvey, Esq.

[4] The Intervention Motion is Docket No. 367. The Movants' Brief in Support of the Intervention Motion ("Movants' Intervention Br.") is Docket No. 369. The Receiver's Response to the Intervention Motion ("Receiver's Intervention Response") is Docket No. 422, and the SEC's Response is Docket No. 420. The Examiner's Brief in connection with the Intervention Motion ("Examiner's Intervention Response") is Docket No. 424. The Movants' Reply on the Intervention Motion ("Intervention Reply") is Docket No. 476.

injunction in order to permit the victims to exercise their rights under the Bankruptcy Code is ripe for immediate determination. Unfortunately, since the Intervention Motion was fully briefed and submitted on June 16, 2009, the need to alter the track that this case is on, and to administer this case under the Bankruptcy Code, has grown more urgent, and each of the reasons identified in the Intervention Motion for transferring this case to the Bankruptcy Court has become more compelling.

In the time since the Intervention Motion was filed, the Receiver has lost the support of essentially *all* the parties and constituencies in this case, from the SEC to the creditors, and confidence in the Receiver and the receivership process has evaporated. As this Court itself has observed, the Receiver has attracted the ire of parties on *all* sides of the case.[5] Among others, United States Senator David Vitter of Louisiana, the state perhaps hardest hit by this fraud, has publicly called for the removal of the Receiver, asking at a field hearing of the Senate Committee on Banking, Housing & Urban Affairs, held in Baton Rouge on August 17, 2009, "How can we end up with such a renegade receiver?"[6] Sentiment toward the Receiver among the investor community has soured considerably, even from the low point it had reached in early summer, when the Examiner observed in response to the Intervention Motion that creditors were losing patience:

> Given the fees sought by the Receiver in his recent fee application [Doc. No. 384], there are few (if any) Investors who view this receivership as a model of efficiency. It is also fair to say that there are few Investors who would agree with the Receiver's assertion that this Receivership has thus far been protective of their due process rights.[7]

The ways in which the injunctions, and the Receiver's actions, have impinged on the

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[5] See Transcript of Proceedings Before the Honorable David C. Godbey, July 31, 2009, at p. 19 (The Court (addressing counsel for the Receiver): "You know everybody in the courtroom is angry with you.").

[6] "Ex-Stanford advisor says SEC warned about bad CD's," by D. Simpson, Associated Press, Aug. 17, 2009, available at http://www.chron.com/disp/story.mpl/business/stanford/6576054.html

[7] Examiner's Intervention Response at p. 7.

Movants' and other creditors' due process rights are substantial, and implicate important public policy concerns. As the Movants argued in their Intervention Motion, Congress has determined that creditors *must* be afforded certain rights in any complex liquidation case. Among other things, in a case under the Bankruptcy Code, the Movants (and other creditors) would have each of the following rights, denied to them in equity receiverships in general, and in this case in particular:

- the right to elect a trustee (11 U.S.C. § 702);
- the right to participate in a meeting of creditors (11 U.S.C. § 341);
- the right to elect a committee to advocate their interests and, through that committee, participate in the proceedings on matters of importance (11 U.S.C. § 705);
- the right to receive notice of motions, and have the opportunity to be heard (Fed. R. Bankr. Pro. 2002(i));
- the right to conduct discovery into Defendants' assets and liabilities, and potential claims that may be brought for the creditors' benefit (Fed. R. Bankr. Pro. 2004);
- the right to litigate their claims under procedures set forth by Congress (11 U.S.C. § 502); and
- the right to share in distributions according to a statutory priority (11 U.S.C. § 726).

As discussed below, the Examiner, in response to the Intervention Motion, agreed that this Court should hold a hearing to determine whether proceeding under the Bankruptcy Code would be preferable to continuing to administer the case as an equity receivership. The Receiver simply opposed the Intervention. In doing so, the Receiver's primary argument in opposition to affording creditors the substantive and procedural rights that they are entitled to under title 11 was that continuing to administer this case as an equity receivership would be more efficient than administering it under the Bankruptcy Code. In effect, the Receiver argued that the victims should be stripped of their statutory rights for the sake of "efficiency." The Movants have thus far been denied in this equity receivership the right to notice and an opportunity to be heard on matters affecting the administration of the estate assets. They have no right in this equity

receivership to elect a trustee who is responsive to their concerns. They have no right in this equity receivership to be represented by an official committee. They have no right in this equity receivership to investigate the assets of the estate and potential claims against third-parties. And the list goes on. The Movants respectfully submit that they should not, and cannot, any longer be deprived of their statutory rights for the sake of "efficiency."

This is especially so now that it is abundantly clear that this equity receivership is *not* going to maximize recoveries for the victims of this massive fraud. The Receiver "is maintaining (and projects that he will continue to maintain) an average 'burn rate' of approximately $1.1 million (or more) in fees and expenses each week."[8] In light of that "burn rate," and the projected recoveries, the Examiner believes that there is a "substantial possibility that the whole of the Receivership Estate could end up, not in the hands of the victimized investors, but in the pockets of the Receiver and the firms he has retained."[9] Thus, this equity receivership now appears to be on track for utter failure by the one measure that matters most: the amount of money that ultimately will be distributed to victims.

While no receiver can be expected to guarantee recoveries to creditors, thousands of victims of the massive Stanford fraud believe that they have been victimized for a second time by this receivership. Among other things, the victims are concerned that the Receiver is spending scarce resources with little benefit, including substantial sums for a public relations firm,[10] essentially using the victims' money to convince them that he is doing a good job while refusing to consider *their* views concerning the administration of the case.

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[8] Brief of the Examiner in Response to the Receiver's Second Interim Fee Application, Dkt. No. 739, at pp. 1-2.

[9] Brief of the Examiner in Response to the Receiver's Second Interim Fee Application, Dkt. No. 739, at p. 2. Not surprisingly, the Examiner believes – as do the Movants – that the Receiver's fee requests are "alarming." *Id.* at p. 1.

[10] *See id.* at 15-16 (the Examiner contends – and the Movants agree – that the victims ought not have to pay for the Receiver's use of a public relations firm to, among other things, coordinate the taking of official photographs of the Receiver).

Perhaps most tellingly, the Securities and Exchange Commission ("SEC"), which initially sought the appointment of, and supported, the Receiver, sought to restrict his authority, suggesting that the SEC itself would perform some the Receiver's functions (including pursuing so-called "clawback" claims) at *no* cost to the victims of this terrible fraud.[11] Unbelievably, the Receiver not only refused this offer that would have conserved limited estate resources, but also spent estate money in an effort to prevent the SEC from doing so.[12] The SEC's loss of confidence in the Receiver, and its effort to limit his authority, was a truly extraordinary, and apparently unprecedented, development.[13]

In all events, even if it were true that victims could be stripped of their rights for their own benefit (*i.e.* for "efficiency") it can no longer seriously be maintained (if it ever could) that the benefits of this equity receivership outweigh the benefits of a bankruptcy proceeding. In balancing victims' rights on the one hand, and "efficiency" on the other, the result is lopsided. On one side of the scale are the victims' substantial and weighty due process and statutory rights granted by law. On the other side of the scale is the victims' likely distribution from the equity receivership: nothing. As the Examiner has explained, "[i]f the purpose of a receivership is to increase the investors' recovery, then it appears we have reached (and likely passed) the point where the Receiver's likely recovery cannot justify the expenses being incurred."[14] It is time to take a hard look at this equity receivership, and to replace it with the well-established statutory scheme embodied in the Bankruptcy Code.

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[11] Plaintiff's Emergency Motion to Modify Receivership Order, Docket No. 613.

[12] Receiver's Response to Plaintiff's Emergency Motion to Modify Receivership Order, Docket No. 657.

[13] See Transcript of Proceedings Before the Honorable David C. Godbey, July 31, 2009, at p. 6, in which the Court asked the counsel for the SEC whether the SEC had "ever asked a court to reign in a receiver before," and counsel for the SEC replied "I'm not aware of one….I am not aware of any time…where the SEC has come in to try to curb some of the authority of the receiver."

[14] *Id.* at p. 3.

The Movants respectfully submit that it is time that victims are afforded the substantive and procedural rights they have been thus far denied in this equity receivership. This equity receivership is neither providing creditors with the rights they are entitled to, by law, nor maximizing their recoveries. This Court therefore should immediately lift the injunction prohibiting the filing an involuntary bankruptcy petition.

Finally, the Movants respectfully request that this Court hear this Motion on an expedited basis, and render a ruling on the Motion as quickly as possible. More than six months into this equity receivership, the Movants are entitled to a hearing and determination as to whether their Congressionally-granted rights as creditors are improperly curtailed by the paragraph 10(e) injunction, and this equity receivership.

Moreover, should this Court disagree with the Movants' position in this Motion, the Movants should be afforded the right to seek appellate review of that decision. The contentions addressed herein implicate important public policy issues concerning the interplay of the Bankruptcy Code and the federal securities laws, which have been addressed by other Courts of Appeals in the decisions discussed below, and the Movants respectfully submit that they should not be deprived of substantial rights without the ability for meaningful appellate review.

PROCEDURAL HISTORY

On February 17, 2009, the SEC commenced this action with by filing a Summons and Complaint and on February 27, 2009, the SEC filed a First Amended Complaint.[15]

The SEC alleges that the Defendants perpetrated a multi-billion dollar fraudulent "Ponzi" scheme by promising "high return rates on… [certificates of deposits] that greatly exceeded those offered by commercial banks in the United States" and selling a "proprietary mutual fund wrap program, called Stanford Allocation Strategy ('SAS'), using materially false and

[15] The First Amended Complaint is Docket No. 48.

misleading historical performance data."[16]

At the beginning of this case, the SEC moved for a temporary restraining order, as well as orders freezing assets, requiring an accounting, requiring preservation of documents, and authorizing expedited discovery. By means of an Order dated February 16, 2009, as amended March 12, 2009 (the "Receivership Order") this Court appointed Ralph S. Janvey as Receiver for the assets and records of the Defendants and all entities they own or control. The Receivership Order, as amended, includes, among other things, the following injunctive provisions:

> 10. Creditors and all other persons are hereby restrained and enjoined, without prior approval of the Court from: …(e) The filing of any case, complaint petition, or other motion under the Bankruptcy Code (including without limitation, the filing of an involuntary bankruptcy petition under chapter 7 or chapter 11 of the Bankruptcy Code, or a petition for recognition of foreign proceeding under chapter 15 of the Bankruptcy Code).
>
> 11. Creditors and all other persons are hereby restrained and enjoined from seeking relief from the injunction contained in paragraph 10(e) of this Order for a period of 180 days from the entry of this Order.

Neither the Movants, nor other investors, were given notice or an opportunity to be heard before the injunctions against them were issued.

On May 11, 2009, the Movants filed the Intervention Motion, seeking relief from the paragraph 11 injunction. In so doing, they argued that this Court should determine at the earliest possible moment in the case whether the creditors would be better served by a bankruptcy filing, both to maximize their recoveries and to afford them the substantive and procedural rights afforded to them by Congress in the Bankruptcy Code. The Movants requested, in the alternative, that they be granted leave to intervene for the purpose of taking an appeal from the Receivership Order.

[16] First Amended Complaint, Docket No. 48, at ¶¶ 3, 6.

The Receiver opposed the Intervention Motion, almost entirely on the ground that equity receiverships are generally more efficient than bankruptcy proceedings.[17] The SEC's short opposition to the Intervention Motion argued simply that this Court had the power to enter the Receivership Order, and that "there [was] no reason, particularly at this early stage, to alter the status quo."[18] (Since the SEC filed that opposition, the SEC itself has sought to "alter the status quo" by obtaining a modification of the Receivership Order that would substantially limit the Receiver's authority. It therefore is not clear whether the SEC still contends the Receiver should be left with unfettered discretion to determine whether a bankruptcy filing is appropriate.)

Significantly, however, the Examiner disagreed with the Receiver, and agreed with the Movants, on the essential aspect of the relief sought in the Intervention Motion, agreeing that the Movants should be afforded a hearing on the issue, and that this Court should "consider, on the merits, whether the Creditors (including the Investors) of the Stanford entities would be better served in bankruptcy proceedings for one or more of those entities."[19]

This Court has not ruled on the Intervention Motion. Thus, more than six months into this receivership, there has been no factual or legal finding with respect to the Movants' argument that their due process and statutory rights have been impinged by the injunctions contained in the Receivership Order, or whether the creditors are entitled to file an involuntary bankruptcy petition against one or more of the defendants.

[17] *See* Receiver's Intervention Response

[18] SEC Intervention Response at p. 3.

[19] Examiner's Intervention Response at p. 2.

ARGUMENT

I. Stanford's creditors, including the Movants, are entitled to the benefits and protections of the Congressionally-established bankruptcy regime.

As the Movants explained in the Intervention Brief, [20] the Receivership Order's injunction prohibiting creditors (including the Movants) from filing an involuntary bankruptcy petition against any of the Defendants implicates compelling public policy and due process concerns.

In a recent case similar to this one, *SEC v. Madoff*, 2009 U.S. DIST. LEXIS 30712 (S.D.N.Y. Apr. 10, 2009) [Apx. at 146], creditors of schemer Bernard L. Madoff sought to lift an injunction that, like the one in effect here, had barred them from filing an involuntary bankruptcy petition. The SEC, the Department of Justice, and the Securities Investor Protection Corporation objected, arguing that they could best control and marshal Mr. Madoff's assets for the benefit of all claimants. Judge Stanton of the Southern District of New York, however, held that the benefits of the rights and procedures guaranteed to creditors in bankruptcy, such as the ones outlined above, outweighed all competing concerns, and required that Mr. Madoff's creditors be afforded the benefits of the Bankruptcy Code:

> No opponent to the relief sought by the motion offers as familiar, comprehensive, and experienced a regime as does the Bankruptcy Code for staying the proliferation of individual lawsuits against Mr. Madoff individually, marshaling his personal assets other than those criminally forfeitable, and distributing those assets among his creditors according to an established hierarchy of claims.
>
> A Bankruptcy Trustee has direct rights to Mr. Madoff's individual property, with the ability to maximize the size of the estate available to Mr. Madoff's creditors through his statutory authority to locate assets, avoid fraudulent transfers, and preserve or increase the value of assets through investment or sale, as well as provide notice to creditors, process claims, and make distributions in a transparent manner under the

[20] The Movants first made these arguments in their Intervention Motion.

> procedures and preferences established by Congress, all under the supervision of the Bankruptcy Court.

Id. at *3-4. Judge Stanton considered, and rejected, the argument that concerns of efficiency trumped the creditors' rights under the Congressionally-established bankruptcy system. He opined that, "[t]he concern that appointment of a Bankruptcy Trustee will increase administrative costs or delay recovery by victims is speculative, and outweighed by the benefits to [the] victims of a Bankruptcy Trustee's orderly and equitable administration of his individual estate." *Id*. at *4. The *Madoff* court therefore concluded that, other than assets subject to criminal forfeiture or liquidation under the Securities Investor Protection Act, "movants should be able to seek the familiar and established relief set by Congress in the Bankruptcy Code." *Id*.

Because Stanford's and Mr. Madoff's victims are (unfortunately) so similarly situated, Judge Stanton's reasoning is compelling here. Stanford's victims, like Mr. Madoff's, are entitled to the rights afforded creditors under the Bankruptcy Code. Here, however, the case for a transfer to the Bankruptcy Court is even more compelling than it was in *Madoff*. Here, the parties need not speculate whether an equity receivership will be more efficient. Through six extraordinary months of bloated bills, with little monetary recovery to show for it, the victims have learned the answer: it will not. This Court therefore should lift the injunction in paragraph 10(e) of the Receivership Order, for the same reasons that the court did so in *Madoff*.[21]

In another similar situation, Judge Porter of this District also concluded that creditors should not be denied their rights under the bankruptcy system. In *Jordan v. Indep. Energy Corp*., 446 F. Supp. 516 (N.D. Tex. 1978) , Judge Porter "resolve[d] a question of first impression in this circuit by deciding under what conditions a federal district court may prevent

[21] By Order dated April 20, 2009, on the motion of federal prosecutors, Judge Denny Chin, also of the Southern District of New York, who is presiding over the criminal case against Mr. Madoff, issued an order restraining Mr. Madoff's assets. Judge Chin's order protects the right of the United States Attorney's Office to seek forfeiture, but does not change Judge Stanton's correct conclusion that the adjustment of general creditor claims and liquidation of an estate should not take place outside of bankruptcy court. [Apx. 145] The case is proceeding in bankruptcy court, which issued an Order for Relief and Order to File Schedules and Other Documents on May 7, 2009. [Apx. 148]

the filing of a voluntary or involuntary petition in bankruptcy by the issuance of a federal blanket receivership injunction."[22] *Id.* at 518-19. In *Jordan*, plaintiffs sued defendant Independent Energy Corporation ("IEC") for securities law violations. The District Court appointed a temporary receiver to take control of IEC's "business operations and assets," *id*. at 520, and "stayed all persons, firms or corporations from 'commencing, prosecuting, continuing or enforcing any suit or proceeding, or from executing or issuing or causing the execution or issuance of any court attachment…or other proceedings for the purpose of impounding or…interfering with any property owned by or in the possession of defendant.'" *Ibid.*[23]

After concluding that federal courts have the power to issue such injunctions, Judge Porter turned to the question of whether to keep that particular injunction in place. The blanket receivership order, the *Jordan* court concluded, "was in the nature of a preliminary injunction and should be tested by the prerequisites for the extreme relief of a preliminary injunction." *Id*., at 529. Specifically, the *Jordan* court considered whether there was:

> (1) a substantial likelihood that the plaintiff will prevail on the merits, (2) a substantial threat that plaintiff will suffer irreparable injury if the injunction is not granted, (3) a threatened injury to plaintiff that outweighs the threatened harm the injunction may do to defendant, and (4) granting of the preliminary injunction will not disserve the public interest.

Id. (citing *Louisiana Envtl. Soc'y, Inc. v. Coleman*, 524 F.2d 930 (5th Cir. 1975)). Then, applying this well-established test, Judge Porter found that:

> **An injunction limiting access to the bankruptcy courts will never satisfy this test**. Congress has enacted a uniform federal bankruptcy policy and has granted the bankruptcy courts power to fairly adjudicate and administer disputes between debtors and creditors. The debtor would be irreparably harmed by the denial of his voluntary access to the rights conferred by the Bankruptcy Act, and **creditors would be irreparably**

[22] Given its broad language and scope, the injunction that the Movants now seek to have lifted is operatively identical to the "blanket receivership injunction" at issue in *Jordan*. *See Jordan*, 466 F. Supp. at 519 n.2.

[23] Although the order did not expressly "restrain a bankruptcy court from proceeding to adjudge IEC a bankrupt and liquidating its assets," *id*. at 523, n. 7, the order "contained two provisions which could be interpreted as prohibiting the filing of an involuntary or voluntary petition in bankruptcy." *Id.* at 520, n. 5.

> **harmed by their inability to secure access to the rights afforded creditors under the Act**. An order restricting access to the bankruptcy court…would not be in the public interest.

Id. at 529-30 (emphasis added). Judge Porter therefore lifted the bankruptcy receivership order and transferred the case to bankruptcy court. *Id*. at 530. Movants respectfully submit that the same result is appropriate here. No less so than in *Jordan*, the Movants here are "irreparably harmed by their inability to secure access" to their rights under the Bankruptcy Code.[24] Thus, this Court should lift the injunction, which prohibits the Movants from exercising their Congressionally-granted rights to have this matter resolved in bankruptcy court.

II. This Court should lift the injunction immediately.

While this Court's appointment of the Receiver initially may have been in the best interests of the creditors, in a case such as this one, a receivership should be an *interim* step, not a permanent one. Otherwise, creditors' rights will be irreparably prejudiced. It is essential that this *interim* measure come to an end.

The Second Circuit Court of Appeals, which repeatedly has addressed this issue, has approved of the short-term use of receiverships to preserve the *status quo*, as this Court has done to date here, but, in doing so, has "'expressed strong reservations as to the propriety of allowing a receiver to liquidate [an estate].' In addition, because receiverships should not be used as an alternative to bankruptcy, [that court has] disapproved of district courts using receiverships as means to process claim forms and set priorities among various classes of creditors." *Eberhardt v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008) (quoting *Lankenau v. Coggeshall & Hicks*, 350 F.2d 61, 63 (2d Cir. 1965) and citing *SEC v. Am. Bd. of Trade, Inc.*, ("*Board of Trade*") 830 F.2d 432, 437-38 (2d Cir. 1987)).

In *Board of Trade, supra* (a case, like this one, in which the individual defendants were alleged to have operated a "Ponzi" scheme, and in which the district court appointed a receiver),

[24] Although decided under the Bankruptcy Act, *Jordan*'s reasoning equally applies under the Bankruptcy Code.

the Second Circuit expressed its very strong disfavor for liquidation in an equity receivership. While acknowledging the occasional necessity of appointing a receiver as an interim measure, the Court explained that it was "disturbed by the subsequent use of the receivership to effect the liquidation of the [defendant] entities." *Id*. at 436. The *Board of Trade* court emphasized that there is "no reason why violation of the Securities Act should result in the liquidation of an insolvent corporation via an equity receivership instead of the normal bankruptcy procedures, which are much better designed to protect the rights of interested parties." *Ibid*. (quoting *Esbitt v. Dutch-Am. Mercantile Corp*., 335 F.2d 141, 143 (2d Cir. 1964)).

Noting that, "[o]n several other occasions [the Second Circuit has] repeated [its] view that equity receiverships should not be used to effect the liquidation of defendants in actions brought under the securities laws," *ibid*, the Court of Appeals held that the district court's actions in the *Board of Trade* case demonstrated why district courts should *quickly* transfer cases like this one to a bankruptcy court:

> [T]he functions undertaken by the district court in this case demonstrate the wisdom of not using a receivership as a substitute for bankruptcy…the district court essentially transformed itself into a court of bankruptcy aided by a receiver performing the tasks of a bankruptcy trustee. For example, the court has taken upon itself the burden of processing proof-of-claim forms filed by thousands of noteholders and other creditors, of setting priorities among classes of creditors, and of administering sales of real property, all without the aid of either the experience of a bankruptcy judge or the guidance of the bankruptcy code.

830 F.2d at 437-38. Here, the Receiver has already announced his intention to begin *the very same process* of "using a receivership as a substitute for bankruptcy" that the *Board of Trade* court warned against. The Receiver is developing his own claims submission and review processes,[25] and apparently intends to liquidate the estates without the protections afforded to creditors under the Bankruptcy Code, and to distribute estate assets according to an as-yet

[25] Report of the Receiver dated April 23, 2009, Docket No. 336, at p. 29.

unknown priority scheme. Thus, the Receiver intends to initiate a process that, according to the *Board of Trade* court, must be conducted under the Bankruptcy Code, and in a bankruptcy court.

The lesson of *Board of Trade*, *Esbitt*, and similar cases, is that an equity receivership becomes entrenched, making transfer to the bankruptcy court increasingly difficult after too much time has elapsed.[26] Most importantly, however, the Second Circuit explained that it wanted to make sure that it would *never again* face a situation in which an equity receivership in an SEC enforcement action remained in place for so long that it made a bankruptcy filing impractical:

> We now state, however, that in actions of the present kind brought in the future by the SEC, we expect counsel for the agency, as an officer of the court and as part of his or her individual professional responsibility, to bring our views, as stated in this and other decisions, to the attention of the district court before the court embarks on a liquidation through an equity receivership.

Id, at 438. The same concerns about having this Court "essentially transform[] itself into a court of bankruptcy aided by a receiver performing the tasks of a bankruptcy trustee," *id*. at 437-38, are as present – and compelling – in this case as they were in *Board of Trade*. The Movants therefore respectfully submit that this Court should lift the injunction "before th[is] court embarks on a liquidation through an equity receivership." *Id.* at 438.

Other Courts of Appeals that have considered the issue have agreed with the Second Circuit that cases such as this one belong in bankruptcy courts, which are specifically designed and equipped to handle such proceedings. These courts also concur that the issue should be addressed early in the proceedings. For instance, in *SEC v. Lincoln Thrift Ass'n*, 577 F.2d 600,

[26] The Second Circuit in *Board of Trade* made clear that it did not order the transfer of the case to bankruptcy court only because, by the time that case had reached the Court of Appeals, the substantial benefits of proceeding under the Bankruptcy Code and Rules already had been lost. As the Second Circuit explained, "because it appears once again that the liquidation is well underway…we conclude, as we did in *Esbitt*, that it 'would ... not be in the interests of the parties to direct that further proceedings be diverted into bankruptcy channels.'" *Id*. at 438. In this case, the receivership clearly has not progressed to the late stage of liquidation that forced the result in *Board of Trade* and *Esbitt*.

601 (9th Cir. 1978) ("*Lincoln Thrift*"), the Ninth Circuit considered an appeal from the denial of a motion by creditors "to wind up a [SEC-] initiated receivership, and to transfer the pending proceedings to a bankruptcy court." The Court explained that, "[t]here are sound policy reasons for allowing liquidation to take place only in a court of bankruptcy," the most prominent of which are: the appointment of a creditors' committee; the requirement that creditors be notified of proposed property sales and have an opportunity for a hearing; and the existence of an "established system" for the distribution of assets. *Id*. at 605. The Ninth Circuit was reluctant, however, to actively manage the receivership by "giving specific orders to the district court as to the method of conducting an equity receivership," and believed that it should not reverse the district court's order "in the absence of clear abuse of discretion." *Id.* at 608-09. As was the case in *Board of Trade*, the Court held that it could not find that abuse of discretion in light of how long the equity receivership had remained in place. *Id.* at 609. The Ninth Circuit, however, made abundantly clear – as did the Second Circuit in *Board of Trade* – that district courts should address very early in the case the issue of whether to transfer a receivership case to the bankruptcy court:

> Our decision is to a large extent controlled by the consideration that the liquidation proceedings were in an advanced stage before appeal was brought to this Court. We do not, therefore, view this case as precedent for approving receivership liquidations under the supervision of the district court rather than under the jurisdiction of the court in bankruptcy. *If the issue arises in future cases, the district court should, at an early stage in the liquidation, set forth in express terms the justification for retaining its equity jurisdiction, indicating why the exercise of its jurisdiction is preferable to a liquidation in bankruptcy court.*

Id. (emphasis added).

The Fourth Circuit also has explained that a complex liquidation, with assets in multiple jurisdictions, should be conducted in the bankruptcy court, and not in an equity receivership. In *Gilchrist v. Gen. Elec. Capital Corp.*, 262 F.3d 295 (4th Cir. 2001), the district court appointed a receiver for all of the assets of Spartan International, Inc. ("Spartan"). A week later, more than

fifty creditors filed an involuntary bankruptcy petition against Spartan. "The district court in South Carolina declined to recognize the automatic stay of all judicial proceedings imposed by 11 U.S.C. § 362(a) with the filing of the bankruptcy petition." *Id.* at 297. On appeal, the Fourth Circuit recognized "that the district court has within its equity power the authority to protect its jurisdiction over a receivership estate through the All Writs Act, 28 U.S.C. § 1651, and through its injunctive powers, consistent with Federal Rule of Civil Procedure 65." *Id*. at 302. But, the Court explained, the district court could not simply ignore the bankruptcy court's Congressionally-conferred jurisdiction over the bankruptcy case, and should *not* have exercised its equitable power under the All Writs Act to, in essence, preempt the bankruptcy proceedings:

> We cannot agree [that the equity receivership should be given priority]. Our examination of the Bankruptcy Code reveals that Congress intended that the bankruptcy process be favored in circumstances such as these….
>
> [W]e do not believe that the equities favor the common-law receivership process over the highly developed and specific bankruptcy process. The procedural requirements for liquidating a large corporation with thousands of creditors…present a task that would push the receivership process to its limits. *See Baldwin-United*, 765 F.2d at 348 ("To whatever extent a conflict may arise between the authority of the Bankruptcy Court to administer this complex reorganization and the authority of the District Court to administer consolidated pretrial proceedings, the equities favor maintenance of the unfettered authority of the Bankruptcy Court"). In this case it can be seen, even from the initial transactions in the receivership, that the customized receivership mechanisms are wanting in comparison with established bankruptcy process…
>
> To resolve the claims involving a large corporation with…thousands of creditors, a bankruptcy court has judicial tools better suited and more specifically tailored to the task…While it is true that the district court has broad equity power, any attempt to use that power to supervise a complex corporate liquidation…would ultimately be more clumsy and expensive than long-established bankruptcy procedures…we are persuaded that in the circumstances of this case, the district court should have recognized the stay provisions of § 362(a).

262 F.3d at 303-4.

Given these strong statements from Courts of Appeals in similar cases, the Movants respectfully submit that this Court should now lift the paragraph 10(e) injunction. Unfortunately, the experience of the last six months has proved the wisdom of the cases discussed above: an equity receivership is by its very nature ill-equipped to handle complex cases such as this one, and is a poor substitute for the well-established procedures of the Bankruptcy Code. The victims are entitled to file an involuntary bankruptcy petition against one or more of the Defendants, and should be permitted to do so.

CONCLUSION

For the reasons set forth above, the Movants respectfully request that this Court lift the injunction contained in paragraph 10(e) of the Receivership Order and grant such other relief as this Court deems just and proper.

Dated: September 10, 2009

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CERTIFICATE OF SERVICE

I hereby certify that on September 10, 2009, I caused the foregoing document to be electronically filed with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to all counsel of record.

/s/ Gregory A. Blue
Gregory A. Blue