

No. 08-4224

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

SECURITIES AND EXCHANGE
COMMISSION,

PLAINTIFF,

v.

VESCOR CAPITAL CORP., *et al.*,

DEFENDANTS.

APPELLANTS' REPLY BRIEF

(Oral Argument Requested)

HERITAGE CAPITAL MANAGEMENT, LLC;
COVENANT BANCORP, INC.; COVENANT
CAPITAL, LLC; HERITAGE ORCAS
PARTNERS, LP; HERITAGE ORCAS VL
PARTNERS, LP; and BOUNDARY BAY
CAPITAL, LLC,

MOVANTS/APPELLANTS,

v.

ROBERT G. WING,

RECEIVER/APPELLEE.

**On Appeal from the United States District Court for the District of Utah
Honorable Judge Dee Benson, Case No. 1:08-cv-00012**

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TABLE OF CONTENTS

TABLE OF CONTENTS..... ii

TABLE OF AUTHORITIES iii

INTRODUCTION iv

ARGUMENT1

 I. THE RECEIVER’S INNUENDO AND *AD HOMINEM* ATTACK
 HAS NO BEARING ON THE MERITS OF THE PRESENT
 APPEAL.....1

 II. CONTROLLING PRECEDENT DOES NOT SUPPORT THE
 SWEEPING EXTENT OF THE STAY.....4

 III. THE COVENANT GROUP SHOULD BE ALLOWED TO
 PROCEED WITH ITS NONJUDICIAL FORECLOSURES IN
 NEVADA BECAUSE THERE IS NO LEGAL BASIS TO STAY
 THEM.....9

 A. The Receiver’s Newly Articulated Theory on Fraudulent
 Conveyance Still Does Not Justify the Stay.10

 B. There Are Limits to the District Court’s Equitable Powers.18

CONCLUSION.....19

CERTIFICATE OF COMPLIANCE WITH TYPE VOLUME LIMITATION,
TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS21

CERTIFICATE OF DIGITAL SUBMISSION22

CERTIFICATE OF SERVICE23

TABLE OF AUTHORITIES

Federal Cases

Ben Ezra, Weinstein, and Company, Inc. v. America Online Inc., 206 F.3d 980
(10th Cir. 2000).....4, 5

Commodity Futures Trading Com'n v. Chilcott Portfolio Mgmt., Inc.,
713 F.2d 1477 (10th Cir. 1983) 4, 5, 10

Fletcher v. U.S., 160 Fed. Appx. 792 (10th Cir. 2005)10

Louisville Stock Land Bank v. Radford, 295 U.S. 555 (1935).....7, 8

S.E.C. v. Wenke, 742 F.2d 1230 (9th Cir. 1984).....4

Utah Women’s Clinic, Inc. v. Leavitt, 136 F.3d 707 (10th Cir. 1998)10

State Cases

Melrose v. Indus. Assoc., Inc., 72 A.2d 469 (Conn. 1950).....7

Federal Statutes

11 U.S.C.A. § 363(f).....9

Other Authorities

65 Am.Jur.2d *Receivers* § 3437

David L. Abney, *Selling Equity Receivership Property Free and Clear of Liens
and Encumbrances*, 16 REAL ESTATE LAW. J. 364 (Spring 1988).....7

INTRODUCTION

Rather than squarely address the legal arguments in the Appellant's Opening Brief, the Receiver ignores controlling precedent and the harm to Secured Lenders. Instead, in the first two pages of his brief, the Receiver falsely implies that Covenant wrongfully raised money on behalf of Vescor and makes an *ad hominem* attack against one of Covenant's officers. As detailed below, the Receiver has absolutely no evidence that Covenant raised money for Vescor and the information about Covenant's officer is legally irrelevant. More importantly, even if true or relevant as to Covenant, the Nevada Foreclosures and the motion made to allow them to proceed, the subject of this appeal, was made by Covenant as Loan Manager for Secured Lenders, who have nothing to with Covenant or how it raised money or what one of its officers may have done in the past. In short, this tactic employed by the Receiver is not becoming of a person of his responsibilities and should be disregarded by this Court.

The Receiver's disregard for Tenth Circuit precedent is an apparent effort to avoid having to respond to and consider the harm to the Secured Lenders. The Stay causes substantial harm by preventing the Secured Lenders from exercising their rights under law. This is particularly true when it is undisputed that the amount of the liens is far in excess of the value of the property and the Receiver has no equity in the property. In addition, the valuable right to credit-bid is being

taken without offering any comparable right. The easiest and most direct way to protect this right is to allow the Nevada Foreclosures to proceed.

The Stay cannot be maintained if there is no legitimate legal basis to prevent the Nevada Foreclosure from proceeding. Since it is undisputed that the Receiver does not have any equity in any of the properties, the only way to justify the Stay is if the Receiver has some cognizable claim to invalidate the liens. As set out below, the Receiver does not have such a claim, and, in fact, he has not offered a viable theory to support such a claim.

The Receiver does not respond to Covenant's arguments regarding a transfer made pursuant to a valid lien, apparently conceding that such a transfer cannot be attacked as a fraudulent conveyance. Instead, the Receiver now for the first time in his appellate brief advances a new theory—one that is based on the assertion that the creation of the lien itself is a fraudulent transfer. Even if such an argument were preserved for appeal, it fails to articulate a viable theory because it ignores an underlying principle of the law of fraudulent conveyance. Namely, the law respects transfers for reasonably equivalent value. The Receiver's theory conveniently forgets that the Secured Lenders, relying on the value of the collateral offered as security, wired millions of dollars to fund loans—this is how the liens were created.

Additional policy reasons abound on why the Receiver's new theory lacks merit. First, the Ponzi-receivership cases, on which the Receiver relies, developed to deal with the problem of early-investors profiting from later-investor money. But the creation of the Secured Lenders' valid liens did not use any later-investor money. Indeed, the money flowed in the opposite direction. The Secured Lenders did not receive payments from Vescor, they were the ones wiring money to Vescor. Thus, by definition, the granting of the trust deeds was not using new investor money to pay old investors—the core of what makes something a Ponzi scheme. Second, investors in a Ponzi scheme typically look to value of the enterprise in hopes on receiving a return on their investment. The Secured Lenders, however, looked to value of the collateral and reasonably relied on the value of the collateral when making the decision to loan money. Third, Ponzi schemes run on fictitious profits and fictitious assets. Given the real, not fictitious, assets in Vescor, on which the secured lenders have valid liens, and given that these assets have real value (otherwise the Receiver and the secured lenders would not be fighting over them), it is uncertain at best whether the Receiver will ever prove that this was a Ponzi scheme. But at the very least, Vescor cannot be called a "Ponzi" with regard to creation of the Secured Lenders' liens. Accordingly, the presumptions in favor of the Receiver's asserted claims have no bearing in the present circumstances.

Finally, the Receiver has not responded to the legal precedent and policy arguments offered by Covenant on why the district court's equitable power is limited to the extent that it cannot set aside valid liens, simply to effectuate a *pro rata* distribution. The Receiver relies almost exclusively on the unfettered discretion of the district court to fashion relief. The Receiver seems to believe that the district court can set aside valid liens simply because it wants to. The Receiver's reliance is entirely hinged to a single case out of the Ninth Circuit, which is marginally on point, at most, and certainly does not expressly promote the broad grant of power that the Receiver suggests.

ARGUMENT

I. THE RECEIVER'S INNUENDO AND *AD HOMINEM* ATTACK HAS NO BEARING ON THE MERITS OF THE PRESENT APPEAL.

Despite their irrelevance, Covenant must first respond to the inappropriate references and suggestions made in the first two pages of Appellee's Brief. In an apparent effort to taint Covenant and prejudice the Court, the Receiver has implied wrongdoing by Covenant and attacked a single person with a relatively small stake in the outcome. The Receiver's efforts to avoid the merits of Covenant's arguments by *ad hominem* attack should not be given any weight whatsoever.

First, the Receiver charges that Covenant "operated as an entity which solicited funds from third parties for investment in Mr. Southwick's enterprise." (Appellee's Br. at 1–2.) Use of the word "solicited" and "for" in this context

suggests that Covenant raised money for Vescor by encouraging others to specifically invest money in Vescor. This is untrue. More importantly, as the Receiver well knows, there is absolutely nothing in the record supporting this charge. In fact, the Receiver did not submit any evidence to the district court even suggesting such activity. To the contrary, the undisputed evidence shows that Covenant has lost substantial sums of money through its lending to Vescor. (App. at 487-91; 501-11.)

Even if it were true that Covenant raised money for Vescor, which it is not, it would have no bearing on all of the other Secured Lenders, who have nothing to do with Covenant's management. As the Receiver also knows, after Vescor went into default on the secured loans, Covenant was elected by the Secured Lenders to act as "Loan Manager" with respect to certain Loan Management Agreements. (App. at 64.) Covenant initiated the Nevada Foreclosures in its capacity as Loan Manager and made the motion to modify the Stay in its capacity as Loan Manager. (App. at 61, 64-66.) Covenant's entire interest in the subject properties is less than twenty-five percent (25%). (App. at 65-66.) The Stay has an equally harmful effect on the other roughly seventy-five percent (75%) of Secured Lenders. To prejudice the Secured Lenders as a whole, based on an unsupported allegation about Covenant, would be manifestly unjust.

Second, the Receiver's inappropriate play on words is compounded by immediately making an *ad hominem* attack on one of Covenant's officers.¹ (Appellee's Br. at 2.) In addition, the Receiver fails to completely advise this Court of the record by omitting the notice of rehabilitation also on file with the district court.² More importantly, the Receiver entirely fails to explain how this prejudicial reference is relevant to the current proceedings. Indicative of its lack of relevance, the Receiver includes the reference in his Statement of the Case but refrains from making such references in his Argument because the Receiver knows that the district court made no reference to Mr. Smith in deciding not to permit the Nevada Foreclosures to proceed. Moreover, in making such suggestive comments and highlighting Mr. Smith's past legal difficulties, the Receiver ignores a pressing fundamental reality: Mr. Smith, who has only a small equity stake in the Covenant entities, has a *de minimis* personal economic interest in the present proceedings. The Receiver's efforts to taint a single person should not have any affect whatsoever on the economic interests of the vast majority of other Secured Lenders, whose interests Covenant represents in seeking relief from the Stay. The

¹ While the Receiver filed documents as a "supplemental exhibit," there is no indication that Judge Benson relied on such irrelevant material in making his decision not to modify the stay to allow the foreclosure to proceed; Mr. Smith was not even mentioned at oral argument.

² In a Certificate of Rehabilitation, the California Court specifically ordered that Mr. Smith "is rehabilitated and is fit to exercise all the civil and political rights of citizenship." (App. at 500.)

issue under appeal—whether it was error not to allow the Nevada Foreclosures to proceed—has nothing to do with Mr. Smith or even with Covenant.

II. CONTROLLING PRECEDENT DOES NOT SUPPORT THE SWEEPING EXTENT OF THE STAY.

A. The Receiver Has Ignored the Controlling Precedent from the Tenth Circuit Regarding the Propriety of a Stay.

Relying wholly on the Ninth Circuit’s opinion in *S.E.C. v. Wenke*, the Receiver does not even mention, much less respond to, the controlling precedent of this Court regarding the conditions in which a stay is appropriate.³ (*See* Appellant’s Opening Br. at 12–14.) Imposition of an injunction against legal action in another state jurisdiction is extraordinary relief. The Receiver’s silence regarding Tenth Circuit precedent and his complete reliance on *Wenke* cannot justify ignoring the harm to third parties affected by such an injunction.

Covenant’s appeal is driven by the well-founded concerns articulated in *Ben Ezra, Weinstein, and Company, Inc. v. America Online Inc.*, 206 F.3d 980 (10th Cir. 2000) and *Commodity Futures Trading Com'n v. Chilcott Portfolio Mgmt., Inc.*, 713 F.2d 1477 (10th Cir. 1983). This Court imposes, on the party requesting a stay, a demanding burden to justify the imposition of a stay, and the purpose behind such protection is to protect the legal rights of the parties affected by the

³ The Receiver also points to *Wenke* to support the distinction between the present stay and a traditional preliminary injunction. (Appellee’s Br. at 8.) But Covenant does not dispute such a distinction. It is the standards for imposing a stay that Covenant requests the Court to consider.

stay. *Commodity Futures*, 713 F.2d at 1484 (instructing that party requesting stay “must make a strong showing of necessity because the relief would severely affect the rights of others”); *Ben Ezra*, 206 F.3d at 987 (“When applying for a stay, a party must demonstrate ‘a clear case of hardship or inequity’ if ‘even a fair possibility’ exists that the stay would damage another party.”).

B. Controlling Precedent Requires That Due Regard Be Given to the Harm on Third Parties.

Despite the mandate established in *Commodity Futures* and *Ben Ezra*, the Receiver gives little regard to the Stay’s harm on the Secured Lenders. The Receiver cursorily suggests that the Stay “causes Covenant no substantial injury because it allows Covenant to assert its claimed security interest in the receivership court.” (Appellee’s Br. at 3.) But this casual remark gives precious little context for how the Secured Lenders are to “assert” their claims in the district court. Consideration of the procedure currently in place displays the risk of substantial harm to the Secured Lenders.

The district court has given the Receiver authority to market the real properties subject to the Nevada Foreclosures and approved a procedure by which the properties will be sold “free and clear” of all prior liens. (App. at 644, 727–28.) To protect the Secured Lenders, the current procedure allows for the Secured Lenders’ liens to attach to the proceeds of any sale. (App. at 644.) In some circumstances this procedure might be sufficient. But when the projected sales

price is insufficient to satisfy the liens, and when the real estate market is depressed, this procedure is wholly inadequate. It is undisputed that the subject properties are seriously over-encumbered, that the face value of the Secured Lenders' liens greatly exceed the estimated fair market value of the properties. (App. at 64–66.) In the current market especially, there is a high likelihood of sales which would cause substantial loss to the Secured Lenders. And it will likely take a great deal of time before the Las Vegas real estate market improves enough so that any sale will generate sufficient proceeds to satisfy the Secured Lenders' liens.

The inadequacy of the currently approved procedure is illustrated by considering the protection which would be available if the Nevada Foreclosures were allowed to proceed. If the prices bid in foreclosure were too low, the Secured Lenders would have a right to credit-bid the properties, giving the Secured Lenders the effective ability to either: (a) cause a higher price to be paid by the cash bidder; or (b) take title and ride out a depressed market. The ability to credit-bid represents a bargained-for right, which provides important, substantive protection for a secured party. And the maintenance of the Stay threatens to impair this important property right.

As a general proposition, a sale free and clear of liens is not proper when the proposed purchase price is less than the liens on the subject property. And a court

should not approve “a sale free and clear of liens if such a sale would result in proceeds insufficient to cover the lienholders and general creditors.” David L. Abney, *Selling Equity Receivership Property Free and Clear of Liens and Encumbrances*, 16 REAL ESTATE LAW. J. 364, 367 (Spring 1988); *see also* 65 Am.Jur.2d *Receivers* § 343 (“[T]he court should not order a sale of the property free from liens unless there is a reasonable prospect that a surplus will be left for general creditors.”); *Melrose v. Indus. Assoc., Inc.*, 72 A.2d 469 (Conn. 1950) (deciding that sale free of clear of liens was not proper when “it appears that the proceeds are insufficient to discharge existing mortgages”).

The underpinning rationale for this general proposition is well-articulated in the opinion authored by Justice Brandeis in *Louisville Stock Land Bank v. Radford*, 295 U.S. 555 (1935). The case centered on the question of whether certain bankruptcy provisions in the Frazier-Lemke Act, designed to protect farmers from foreclosure, were constitutional. 295 U.S. at 572–73. The Court determined that the provisions were unconstitutional, because they allowed takings of property without compensation. *Id.* at 601–02. The property at issue was the property rights of a mortgagee (a secured lender), and the Court listed five property rights provided under state law. *Id.* at 594. Included in this list of five property rights was the right to credit-bid the property, as stated by the Court, it is “[t]he right to protect [the secured lender’s] interest in the property by bidding at such sale

whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.” *Id.* at 594–95.

The Court’s opinion lays out the historical importance of these property rights, recognizing that “[f]or centuries efforts to protect necessitous mortgagors have been persistent.” *Id.* at 578. As Justice Brandeis explained, the development of a lien theory of mortgage, away from an instant conveyance theory, was conditioned on developing adequate protection for the mortgagee. *Id.* at 578–79.

In the words of the Court,

the statutory command that the mortgagor should not lose his property on default had always rested on the assumption that the mortgagee would be compensated for the default by a later payment, with interest, of the debt for which the security was given; and the protection afforded the mortgagor was, in effect, the granting of a stay. No instance has been found, except under the Frazier-Lemke Act (11 USCA s 203(s), of either a statute or decision compelling the mortgagee to relinquish the property to the mortgagor free of the lien unless the debt was paid in full.

Id. at 579. In further discussion, the Court emphasized the importance of the credit-bid right, explaining that “[t]o protect his right to full payment or the mortgaged property, the mortgagee was allowed to bid at the judicial sale on foreclosure.” *Id.* at 580.

If the right to credit-bid is lost, then it should be replaced by some comparable right. Indeed, where the bankruptcy code expressly allows sales free

and clear of all liens, such a safeguard has been codified in the bankruptcy laws. *See* 11 U.S.C.A. § 363(f).⁴ Without this or some other comparable right, the Secured Lenders stand to lose substantial amounts. But no comparable right is currently provided.

Simply put, the currently approved procedure is inadequate because it does not include the right to credit-bid or some comparable right. If the Stay is sustained, the Secured Lenders' claims will undoubtedly languish for some time. During this time, there is a significant risk that the Receiver will consummate sales which produce insufficient proceeds to cover the amount of the Secured Lenders' liens. The potential harm to Secured Lenders is great; the Stay should be lifted with regard to the Nevada Foreclosures.

III. THE COVENANT GROUP SHOULD BE ALLOWED TO PROCEED WITH ITS NONJUDICIAL FORECLOSURES IN NEVADA BECAUSE THERE IS NO LEGAL BASIS TO STAY THEM.

Covenant realizes that the district court has discretion in applying the standards for imposing a stay established in controlling precedent, and Covenant does not challenge the district court's weighing or discerning of any of the relevant facts. The district court cannot, however, rely on mistaken conclusions of law to

⁴ The development of adequate safeguards in bankruptcy law has rendered the *Radford* opinion, discussed above, not hugely influential in modern bankruptcy jurisprudence. The Receiver's proposal to sell free and clear of liens, however, revives the significance of this decision. Without adequate protection for lienholders, the constitutional concerns raised in *Radford* become paramount.

enjoin legal action in a separate, state jurisdiction. *See Commodity Futures*, 713 F.2d at 1484 (finding abuse of discretion when there is a “lack of sufficient justification for the stay”); *Fletcher v. U.S.*, 160 Fed. Appx. 792, 795 (10th Cir. 2005) (recognizing *de novo* standard for any legal conclusions underlying district court ruling which was subject to abuse of discretion standard); *Utah Women’s Clinic, Inc. v. Leavitt*, 136 F.3d 707, 709 (10th Cir. 1998) (same). There has been an abuse of discretion because of such reliance. Regard for the correct legal standards on the underlying legal issues reveals that there is no foundation for the Stay. As set forth in Appellant’s Opening Brief and below, the Stay is based on mistaken legal conclusions. Consequently, the Stay should be lifted.

A. The Receiver’s Newly Articulated Theory on Fraudulent Conveyance Still Does Not Justify the Stay.

Because he has not responded to the statutory analysis and cases presented in Covenant’s opening brief, it appears that the Receiver concedes that subsequent cash payments and proceeds received by Secured Lenders cannot, by statutory definition, constitute a fraudulent transfer, so long as the underlying liens are valid. As detailed in our opening brief, the statute expressly excludes transfers subject to a valid lien. (*See* Appellant’s Opening Br. at 7–12.) Instead, the Receiver, in his appellee’s brief, offers a new theory not advanced below. He now argues, based on the argument that the giving of the lien itself somehow constitutes the transfer which the Receiver may attack. (Appellee’s Br. at 5 (“The Receiver is not seeking

the proceeds of the foreclosure of the alleged lien but rather is attacking the conveyance of the property interest which purports to create the lien.”.) Even assuming, for the sake of this appeal only, that the Receiver can successfully bring a fraudulent conveyance claim against the Secured Lenders, this new theory cannot justify the Stay.

1. There Are Numerous Holes in the Receiver’s New Theory.

First, the Receiver did not articulate this theory below, and such an argument is not preserved for appeal because the district court did not consider this argument in making its decision. *Chihuahuan Grasslands Alliance v. Kempthorne*, 545 F.3d 884, 893 n.8 (10th Cir. 2008) (“Ordinarily we will not consider a new theory raised on appeal, even if it falls under the same general category as an argument raised at trial.”). Regardless, to the extent such an argument was articulated below and is considered on appeal, it also lacks merit and cannot form the basis for the imposition of the Stay.

Second, the Receiver’s theory fails the test of common sense. Consider the basic mechanics: (1) pursuant to a duly-executed promissory note, a lender wired a substantial sum of money to an entity holding title to real estate; and (2) the entity holding title executed an instrument, which was then duly-recorded in the appropriate county recorder’s office, to secure the lender’s lien on the subject real

estate. This transaction, at its core, is no different than the multitude of mortgage transactions which occur on a daily basis.⁵

The Receiver's theory depends completely on the identity of the promissor. Because Val Southwick was allegedly running a Ponzi scheme, the Receiver reasons, an entity under his control could not give a mortgage without it being a fraudulent transfer. According to this reasoning, the Receiver could attack, as a fraudulent transfer, every instance in which Southwick or Vescor purchased office supplies. Such an absurd result cannot be the law, and consideration of the underlying policies behind the law of fraudulent conveyance reveals the infirmity of such a position.

Third, there is considerable doubt that the Receiver will be able to prove the predicate that this was a "Ponzi scheme" in circumstances such as these. The Ponzi-receivership cases generally deal with a situation in which the characterization of a "Ponzi scheme" was not terribly controversial. *See Sender v. Buchanan (In re Hedge-Investments Assoc., Inc.)*, 84 F.3d 1281, 1282 (10th Cir. 1996) (recognizing "elaborate and long-running Ponzi scheme" in first sentence). While such a characterization will likely be disputed at every turn in this case

⁵ Had a Secured Lender wired \$100 and received a lien for \$100,000, then the Receiver's theory might have some merit. But there is no dispute that the liens given accurately reflected the actual amount of money originally wired to fund the loans. (App. at 488, 503.)

(because of the valuable assets owned by Vescor), applying such a label with regard to the creation of a lien on real property is especially inappropriate.

Ponzi schemes involve situations where there is nothing “behind the curtain” except the use of later-investor money to feed the perception of profitable returns. But the Secured Lenders’ liens were on valuable pieces of commercial real property in Las Vegas. These properties were not fictitious—they were, and are, actual dirt and sometimes buildings. It is true that these properties have suffered because of the precipitous decline in the value of commercial real properties in and around Las Vegas, Nevada—but this does not make a venture into a Ponzi scheme. It certainly does not support a contention that a “Ponzi” label should satisfy the actual intent element for a claim attacking the creation of the lien itself. However it may have acted in other contexts, Vescor certainly did not act like a “Ponzi” when borrowing money from the secured lenders, using real pieces of valuable real estate as collateral. Accordingly, the presumption of actual intent should not apply in the present circumstances.

Fourth, even if the Receiver can prove the real estate involved here was part of a Ponzi scheme, in those cases where the courts found actual intent as a matter of law occurred in situations where a fraudulent transfer claim has been used to recover transfers to people: (1) who had received commission payments for services rendered in the actual furtherance of the fraud; or (2) who had received

more money back than they had originally invested. *See Donell v. Kowell*, 533 F.3d 762 (9th Cir. 2008) (generally discussing use of fraudulent conveyance claim by receiver or trustee). With the first set, imposing a burden to show good faith makes good sense, as such actors were active participants in the underlying fraud. With the second set, applying an equivalent value test which does not recognize the value of satisfying antecedent debt prevents a wind-fall to early investors at the expense of later investors.

2. The Receiver's New Theory Is Not Supported By Underlying Policy Considerations.

The Receiver's theory rests on a distortion of the fledging law which has developed in conjunction with the use of a fraudulent transfer claim by a Ponzi receiver. The primary advantage of this claim is that some courts will allow a Ponzi receiver to establish the threshold intent element for actual fraud by a determination that there was Ponzi scheme. *Merrill v. Abbot (In re Independent Clearing House)*, 77 B.R. 843, 860 (D. Utah 1987) (applying fraudulent conveyance provisions in Bankruptcy Code). Proceeding under actual fraud allows the receiver to avoid proceeding under constructive fraud, which would add additional elements to the receiver's *prima facie* case and allow a defendant to resolve the claim on the basis of reasonably equivalent value.

If a court allows the primary actual intent element satisfied as a matter of law, there is a dramatic legal effect, allowing the Ponzi receiver to: (1) switch the

burden on proving equivalent value; and (2) impose a burden on a recipient to prove good faith as an affirmative defense. *See, e.g., Terry v. June*, 432 F.Supp.2d 635, 644 (W.D. Va. 2006) (“[T]he burden shifts to the transferee to prove that he received the transfer in objective good faith and for reasonably equivalent value.”).

Being forced to affirmatively proving good faith poses an unfair burden on the Secured Lenders. While Covenant and the Secured Lenders will ultimately prevail on a good faith defense—they certainly would not have wired money if they knew it was a fraud—having the burden to prove good faith will force them to engage in expensive and time-consuming litigation, on an element which is inherently fact-intensive. This is particularly true here where it is undisputed that Covenant received from Vescor far less than it advanced to Vescor. (App. at 487–91; 501–11.) Imposing this burden, for no other reason than the fact that Southwick was a fraud, unfairly forces an innocent lender to incur the costs of making an affirmative case. Accordingly, the ability of a Ponzi receiver to establish actual intent as a matter of law should be limited, in accord with existing precedents, to situations in which the Ponzi has made cash disbursements to investors and participants.

Allowing the actual intent element to be satisfied by a district court’s determination of a Ponzi scheme reflects an understandable desire to do justice in a difficult situation. For the basic proposition that such a determination can satisfy

the intent element, the Receiver relies on *Merrill v. Abbot*. (See Appellee’s Br. at 6.) There, the district court was grappling with how to handle claims against people who had received payments in excess of the amounts originally invested in an undisputed Ponzi scheme. With regard to the central issue of equivalent value, the court “conclude[d] that the debtors received a ‘reasonably equivalent value’ in exchange for all transfers to a defendant that did not exceed the defendant’s principal undertaking but, to the extent a defendant received more than he gave the debtors, the debtors did not receive a reasonably equivalent value.” *Merrill*, 77 B.R. 843, 857 (D. Utah 1987)

This finding was premised on a rejection of the underlying investment contract. Confronted with the argument that payments were for reasonably equivalent value because they were made pursuant to an existing investment contract, the court “conclude[d] that, as a matter of public policy, the contracts involved in this case were unenforceable to the extent they purported to give the defendants a right to payments in excess of their undertaking.” *Id.* at 858. See also *Sender v. Buchanan (In re Hedge-Investments Assoc., Inc.) (“Buchanan II”)*, 84 F.3d 1286, 1290 (10th Cir. 1996) (“We find the district court’s reasoning in *Merrill* persuasive and reach the same conclusion.”). Underlying the court’s rationale was the desire to prevent a wind-fall to early investors, at the expense of later investors. *Id.* at 870 (“The fortuity that these defendants got into the scheme early enough to

make a profit should not entitle them to a reward at the expense of equally innocent undertakers who entered the scheme later, perhaps as a result of misplaced faith borne of prior undertakers' success.”). *See also Buchanan II*, 84 F.3d at 1287 (“In effect, Mr. Donahue ran a Ponzi scheme—he paid these so-called profits to investors who chose to make cash withdrawals with the contributions of other investors.”).

The same policy considerations do not apply in the present situation. By definition, Vescor did not use later-investor money when it provided a lien to Secured Lenders. Indeed, the cash flowed in the opposite direction. The wiring of real funds is not analogous to the satisfaction of antecedent debt to investors under suspect investment contracts. For this reason alone, if no other, the creation of a lien should be distinguished, and the previous Ponzi fraudulent transfer cases should have no applicability.

The expectations of the parties provide additional grounds to distinguish the creation of a lien. Investors fronting money under an “investment contract” or similar arrangement are vested in, and rely on, the success on the Ponzi enterprise. When a Ponzi is discovered, early-investors, as unsecured creditors are generally foreclosed, under existing precedents, from profiting from such an enterprise. A secured lender, however, relies on the value of the collateral; the lender does not look to the success of the enterprise but rather depends on the value of the collateral to effect recovery. There is no comparable consideration to disallow the

secured lender's reliance on the collateral. Moreover, the fraudulent conveyance statute expressly acknowledges this distinction by expressly exempting transfers subject to a valid lien. (*See* Appellant's Opening Br. at 9-12.)

A finding of actual intent as a matter of law, with its imposition of the burden to affirmatively prove good faith, is not appropriate in a case when the purported transfer resulted in money coming into the debtor's estate. The estate was not harmed in any way when such a transaction occurred. And the policy rationale for ignoring the value of relieving antecedent debt simply does not apply in these circumstances.

Consequently, this Court should rule that a "Ponzi" determination does not result in a satisfaction of actual intent, when the purported transfer is the giving of a lien on real property which accurately reflects the amount of money contemporaneously provided to the debtor. Because it is undisputed that the Secured Lenders gave equivalent value for the liens by funding the loans on which the liens are based, the Court should then also rule that the Receiver's new theory has no merit in the present circumstances. Accordingly, it cannot justify the Stay.

B. There Are Limits to the District Court's Equitable Powers.

In his Summary of the Argument, the Receiver states that "Covenant asserts that the District Court acted improperly in setting aside its liens, the court below made no such ruling." (Appellee's Br. at 2.) This is a mischaracterization of

Covenant's position; Covenant has never asserted that the district court made such a finding. The limits of the district's court's equitable power are relevant only to the extent that the subject power provides legal foundation for the imposition of the Stay. Because the district court does not have the power to set aside valid liens for the sole purpose of effectuating a *pro rata* distribution, the Stay lacks foundation and should be lifted.

The Receiver has not responded to the law surrounding the general rules of receivership or the sound policy arguments offered in Appellant's Opening Brief. The Receiver continues to rely solely on *S.E.C. v. American Capital*, 98 F.3d 1133 (9th Cir. 1996). But he does not address the critical distinction between *perfected* security interests and the clearing of "wilds deeds" which was briefly discussed in *American Capital*. The Receiver certainly does not suggest how the purpose of effectuating a *pro rata* distribution justifies turning well-founded property law principles on their head. For all of the reasons indicated in Covenant's opening brief, this Court should clarify that the district court does not have the power to set aside valid liens for the sole purpose of effectuating a pro-rata distribution. (*See* Appellant's Opening Br. at 1–7.)

CONCLUSION

The Receiver has not responded to the weight of legal argument presented in Appellant's Opening Brief. He has refused to address the controlling Tenth Circuit

precedent governing the issuance of a stay and, specifically, the heightened standards which apply when the stay enjoined legal action in another jurisdiction. He has avoided discussion of the statutory analysis and discussion of cases on his fraudulent conveyance claim, apparently conceding that Covenant's underlying position is correct. Instead, he generally asserts a new theory attacking the original creation of the liens. This theory, however, fails to consider the undisputed, equivalent value given in exchange for the liens. Furthermore, the Receiver stubbornly insists that the district's court equitable powers are unlimited, despite the many authorities cited and the policy arguments made by Covenant to support reasonable limitations. In sum, the legal positions of the Receiver do not support maintenance of the Stay. Accordingly, the Court should reverse the order of the district court and lift the Stay with respect to the nonjudicial foreclosures in Nevada.

Dated this 11th day of May, 2009.

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I hereby certify that on this 11th day of May, 2009, I caused a true and correct copy of the **APPELLANTS' REPLY BRIEF** to be sent via email and first class mail, postage pre-paid, to the following:

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