

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In Re:)	
)	
MARVIN LEE WILCOX,	)	Case No.: 10-6056
PAMELA JEAN WILCOX,)	
	)	APPEAL FROM UNITED STATES
Debtors,	)	DISTRICT COURT FOR THE
	)	WESTERN DISTRICT OF
	)	OKLAHOMA;
	)	CASE NO.: CIV-09-186D
	)	HONORABLE TIMOTHY DeGIUSTI
OKLAHOMA DEPARTMENT OF)	
SECURITIES <i>ex rel.</i> IRVING L.	)	BANKRUPTCY CASE NO.
FAUGHT, Administrator, et al.,	)	BK-07-10610-BH
	)	ADVERSARY NO. 07-1226
Plaintiff/Appellee,)	
)	
v.)	
)	
MARVIN LEE WILCOX,)	
)	
Defendant/Appellant.)	

BRIEF IN CHIEF OF THE APPELLANTS
MARVIN LEE WILCOX AND PAMELA JEAN WILCOX

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF OKLAHOMA CASE NO.: CIV-09-186D;
THE HONORABLE TIMOTHY DeGIUSTI

ORAL ARGUMENTS
REQUESTED

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CORPORATE DISCLOSURE STATEMENT

The Appellant is not required by Federal Rules of Appellate Procedure 26.1 to file a disclosure.

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I. STATEMENT OF RELATED CASES

This is a related case pending before this court styled, In re: Robert William Mathews, Debtor; Oklahoma Department of Securities vs. Robert William Mathews, Case No. 10-6057.

II. JURISDICTIONAL STATEMENT

This is an appeal from a final judgment of the United States District Court for the Western District of Oklahoma and is taken pursuant to Rules 3 and 4 of the Rules of Appellate Procedure and 28 U.S.C. § 158(d). The final judgment was entered on February 10, 2010 and the Notice of Appeal was filed on March 5, 2010. The Appeal to the United States District Court was taken from a final judgment of the bankruptcy court pursuant to 28 U.S.C. § 158(a)(1) and Bankruptcy Rule 8001. The final judgment of the bankruptcy court was filed on December 12, 2008 and the Notice of Appeal by Marvin Lee Wilcox and Pamela Jean Wilcox was filed on December 22, 2008 pursuant to Bankruptcy Rules 8001 and 8002. The Appellants elected to appeal to the United States District Court for the Western District of Oklahoma by filing the Notice of Appeal to the District Court on December 22, 2008 pursuant to 28 U.S.C. § 158(c)(1)(A).

III. STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. The District Court erred in affirming the Bankruptcy Court's findings that there were sufficient undisputed facts to entitle the

Oklahoma Department of Securities to summary judgment and finding that the Plaintiff had met its burden of proof under 11 U.S.C. § 523 (a)(19), as a there were numerous disputed facts, which precluded summary judgment in the bankruptcy case.

2. The District Court erred in affirming the Bankruptcy Court's decision that the Oklahoma Department of Securities had met its burden of proof, that the discharge should be denied the Appellants, Marvin Lee Wilcox and Pamela Jean Wilcox based on 11 U.S.C. § 523(a)(19).

3. The District Court erred in affirming the Bankruptcy Court's opinion finding that the decision of the District Court of Oklahoma County found that the Appellants, Marvin Lee Wilcox and Pamela Jean Wilcox had violated federal securities laws, which is an essential requirement for a denial of discharge under 11 U.S.C. § 523 (a)(19).

4. The District Court erred in affirming the Bankruptcy Court's decision finding that Oklahoma law does not require wrongful intent in order to prove a violation of Oklahoma securities laws.

5. The District Court erred in affirming the Bankruptcy Court's findings that the Appellants Marvin Lee Wilcox and Pamela Jean

Wilcox under the undisputed facts presented should have been denied a discharge under 11 U.S.C. § 523(a)(19).

6. The District Court erred in affirming the Bankruptcy Court's findings that were based on an Oklahoma Court of Civil Appeals decision, which has been subsequently vacated and the case reversed and remanded for further proceedings.

7. The District Court erred in affirming the Bankruptcy Court's decision in finding that Marvin Lee Wilcox and Pamela Jean Wilcox had met the requirements under 11 U.S.C. § 523(a)(19) for denial of their discharge.

8. The District Court erred, in that its decision is based in part on the affirmance of the Oklahoma County District Court decision by the Oklahoma Court of Civil Appeals, which required disgorgement of the profits received by Appellants Wilcox. The Court of Civil Appeals decision had subsequently been vacated and that case reversed and remanded for further proceedings in the District Court of Oklahoma County.

9. The District Court erred as part of its decision was based upon the Oklahoma Court of Civil Appeals decision holding that "the defense of being innocent victims" has no merit under the facts of this

case. That Court of Civil Appeals decision was vacated and the case reversed and remanded for further proceedings.

IV. STATEMENT OF THE CASE

The Appellants, Marvin Lee Wilcox and Pamela Jean Wilcox (herein after referred to as the "Wilcoxes"), were two of the numerous victims of a Ponzi scheme run by Marsha Schubert d/b/a Schubert and Associates ("Schubert"). Beginning on or about 2001, Schubert, an individual residing in Oklahoma engaged in the issuance, offer, and sales securities to "Investors." Schubert represented that the Investors would pool their funds and would gain large profits from the investment through Schubert's day trading. Schubert stated that the Investors' money would be used to make trades on option contracts and promised that the investment program was full-proof and would bring profits of 30% annually. The Wilcoxes, like other investors, placed their trust and confidence in Schubert to act for their benefit in this investment program.

It was subsequently discovered that Schubert was in fact running a Ponzi scheme and the Wilcoxes were investors/victims, just like all of the other numerous investors caught up in Schubert's Ponzi scheme. The Oklahoma Department of Securities ("Department of Securities") sued Wilcox, and 158 other Investors of Schubert in Oklahoma County District Court, alleging these investors had received more funds than they had invested with Schubert and sought to have

those funds disgorged to a Trustee appointed by The District Court of Logan County to gather funds in order to repay investors.

In The District Court of Oklahoma County, in a case styled *Oklahoma Department of Securities, Ex Rel, Irving L. Faught, Plaintiff v. Marvin Lee Wilcox and Pamela Jean Wilcox, et al.*, Case No. CJ-2005-3796, the Court found that the Wilcoxes, had been *unjustly enriched* and ordered the Appellants, along with 158 other investors of Schubert, in this case to disgorge the funds the investors received from Schubert. That case has subsequently been reversed by the Oklahoma Supreme Court and remanded for further proceedings.¹

Subsequently, the Wilcoxes sought bankruptcy protection in The United States Bankruptcy Court for the Western District of Oklahoma, Case No. BK 07-10610 BH. The Department of Securities, sought to have the Wilcoxes' discharge denied in an adversary proceeding in the bankruptcy court alleging that 11 U.S.C. § 523(a)(19) disallowed discharge of the state court judgment to the Wilcoxes. The bankruptcy court in its order, found in favor the Department of Securities and against the Wilcoxes, and from that order, the Wilcoxes have appealed to the U.S. District Court, which affirmed the bankruptcy court which necessitated this appeal, to the Tenth Circuit.

¹The Wilcoxes judgment was reversed; however, the case has been remanded for further proceedings so any new judgment would be subject to the same claims by the Department of Securities.

V. RELEVANT FACTS

1. On October 14, 2004, the Department of Securities sought an application for temporary restraining order and freezing assets of Schubert, with respect to the Ponzi scheme that she was operating. (*See* Appendix pages 235 - 249)

2. On November 15, 2004, an Order for permanent injunction was entered enjoining Schubert from offering or selling any securities, transacting business as a broker/dealer, and ordered that Schubert should pay restitution to investors in a sum to be determined by the Court. (*See* Appendix pages 251 – 260 and 261 - 266)

3. On April 13, 2005, in Case No. CR-05-078-HE, Schubert petitioned the United States District Court to enter a plea of guilty in her criminal case. (*See* Appendix pages 266 - 277)

4. On September 7, 2005, a judgment in said criminal case was entered on a plea of guilty to one (1) count of money laundering against Schubert, and she was ordered imprisoned for 120 months and ordered to pay restitution in an amount and in excess of \$9,000,000.00. (*See* Appendix pages 278 - 288)

5. On May 11, 2005, the Department of Securities filed in the District Court of Oklahoma County, Case No. CJ-2005-3796, a suit against numerous former investors of Schubert, which included the Wilcoxes. In that petition, it was

alleged that the defendants, including the Wilcoxes, had received money from Schubert and that they had been unjustly enriched to the detriment of other investors. (*See* Appendix pages 304 - 316)

6. On October 24, 2006, the Department of Securities in Case No. CJ-2005-3796, filed a motion for summary judgment against the Wilcoxes, alleging only that they had been unjustly enriched as investors with Schubert. In the motion for summary judgment, they argued that the Department of Securities was entitled to summary judgment because the Wilcoxes were unjustly enriched by payments they received from Schubert and alleged that they had received fictitious profits in the amount of \$509,505.56 from Schubert. In the motion for summary judgment filed by the Department of Securities, they did not make any allegations of any wrongdoing or securities violations on the part the Wilcoxes in this case. (*See* Appendix pages 337 - 343)

7. On February 5, 2007, the District Court of Oklahoma County, entered summary judgment against the Wilcoxes in this case and found that the Wilcoxes had been unjustly enriched in the amount requested by the Department of Securities. The Court made no findings of any wrongdoing on the part of the Wilcoxes. (*See* Appendix pages 459 - 462)

8. As a result of a state court judgment against the Wilcoxes, they filed for bankruptcy protection in The United States Bankruptcy Court for the Western District of Oklahoma in a Chapter 7 case, Case No. BK 07-10610 BH.

9. On October 25, 2007, the Department of Securities filed an adversary proceeding, Case No. 07-1226 BH, seeking to deny Wilcoxes' discharge of the state district court judgment on the basis of 11 U.S.C. § 523(a)(2) and (a)(19). (*See* Appendix pages 69 - 77)

10. On May 30, 2008, the Department of Securities filed its motion for summary judgment in the adversary proceeding, seeking to deny discharge to the Wilcoxes for the state court judgment. In its motion for summary judgment, the Department of Securities alleged that the state court judgment should be nondischargeable under 11 U.S.C. § 523(a)(19) as it was related to a securities violation and there was an order of disgorgement. The Wilcoxes filed a response on June 25, 2008, alleging that they were not participants in the scheme of Schubert and that Schubert had committed all of the wrongful acts and the securities violations. Appellants argued they were merely investors with Schubert, just like all the other investors who were victims of Schubert's scheme. The lack of involvement in Schubert's scheme by the Wilcoxes is uncontroverted. (*See* Appendix pages 103 – 143 and 144 - 187)

11. On December 12, 2008, the Bankruptcy Court entered judgment in favor of the Department of Securities and against the Wilcoxes, finding that under 11 U.S.C. § 523(a)(19) of the Bankruptcy Code that the debt of the state court judgment ordering disgorgement for unjust enrichment was nondischargeable in bankruptcy. (See Appendix pages 570 – 576 and 577 - 578)

12. The Wilcoxes appealed the state court judgment against them and the court of civil appeals affirmed the state court in Case No. 104,262 on April 13, 2007. The Oklahoma Supreme Court reversed the judgment against the Wilcoxes and remanded for further proceedings.

(See Appendix pages 467 – 490 and *Oklahoma Department of Securities v. Blair*, 2010 OK 16; – P. 3rd –.

It is from the decision of the Bankruptcy Court affirmed by the U. S. District Court denying the Wilcoxes discharge that the Wilcoxes have taken this Appeal.

VI. SUMMARY OF ARGUMENT

The Wilcoxes were targets of Schubert's Ponzi scheme. The facts are uncontroverted that Schubert was the wrongdoer. Schubert was the person who violated the securities laws. The Wilcoxes merely invested their money with Schubert, who the Wilcoxes believed was a legitimate day trader. There were no allegations that the Wilcoxes were wrongdoers and the order from the District Court of Oklahoma County found that the Wilcoxes, along with other investors

with Schubert, were unjustly enriched. The Oklahoma County District Court did *not* find that the Wilcoxes or the other investors were wrongdoers.

Title 11 U.S.C. § 523(a)(19) is targeted to deny discharge in bankruptcy based on the debtor's violation of securities laws. It was intended to prevent wrongdoers from using the bankruptcy laws from receiving a discharge. In this case the wrongdoer (Schubert) is not the debtor. The person who violated the securities laws was Schubert and not the Wilcoxes (who are the debtors). Since the Wilcoxes are not the wrongdoers 11 U.S.C. § 523(a)(19) cannot be used to deny the Wilcoxes of a discharge. For this reason the bankruptcy court and U. S. District Court have improperly applied § 523(a)(19) to the Wilcoxes and these decisions should be reversed.

VII. ARGUMENTS AND AUTHORITIES

PROPOSITION I

THE U. S. DISTRICT COURT ERRED IN AFFIRMING THE BANKRUPTCY COURT'S FINDING THAT THE OKLAHOMA DEPARTMENT OF SECURITIES HAD MET ITS BURDEN IN PROVING THAT THE DISCHARGE OF THE STATE COURT JUDGMENT SHOULD HAVE BEEN DENIED THE WILCOXES BASED ON 11 U.S.C. § 523(A)(19).

A. STANDARD OF REVIEW

This is an Appeal from Final Order of the U. S. District Court Affirming the Granting of Summary Judgment by the bankruptcy court.

The bankruptcy court made a legal conclusion that the Wilcoxes discharge should be denied as to the state court judgment pursuant to 11 U.S.C. § 523(a)(19) of the bankruptcy code. Those findings were affirmed by the U. S. District Court. Legal conclusions or determination of a bankruptcy court are subject to a *de novo* review on appeal to the U. S. District Court. *In re Herd*, 840 F.2d 757 (10th Cir. 1988). *See also, In re Hollytex Carpet Mills, Inc.*, 73 F.3d 1516 (10th Cir. 1996). Additionally, issues of whether debts are dischargeable under 11 U.S.C. § 523 are questions of law and are subject that are reviewed *de novo*. *In re Woodcock*, 45 F.3d 363 (10th Cir. 1995).

B. ARGUMENT

This argument covers issues 2, 3, 4, 5 of 7 of the Issues on Appeal set forth above.

In early 2002, Congress introduced the Sarbanes-Oxley Act (“SOA”) in response to wrongdoing by corporate executives at Enron and the perceived negative effect said had on the capital markets. Title VIII of the SOA entitled, “The Corporate and Criminal Accountability Act (“CCAA”),” was designed to punish corporate criminals and hold them accountable for defrauding investors. [S. REP. NO. 107-146, at 2 (“[An Act] to provide for criminal prosecution and enhanced penalties of persons who defraud investors in publicly traded securities...

to disallow debts **incurred in violation of securities fraud laws** from being discharged”) (Emphasis added).]

Included in § 803 of the CCAA was an amendment to § 523(a) of the Bankruptcy Code, adding subsection (19) to the exceptions to discharge. U.S.C. § 523(a)(19) states that it applies to a debt that

(A) *is for*—

(i) *the violation* of any of the Federal securities laws . . . , any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, before, on, or after the date on which the petition was filed, from—

(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor. (Emphasis added)

Paragraph (A)(i) will only except from discharge a debt that “is for - the violation” of the securities laws. A court cannot ignore a term or phrase selected by Congress. *See Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001) (noting each provision within an act must have an intended meaning); *United*

States v. Coward, 296 F.3d 176, 183 (3rd Cir. 2002) (meaning should be given to each statutory phrase). Plaintiff's argument can be summed up as a novel interpretation of the preposition "for" and the term "violation." The dictionary defines "for" in the very context used in the statute as "for - in punishment of ... as in *payment for the crime*." The bankruptcy court's decision has the effect to hold that the Congress in using the preposition "for," meant nondischargeability of a debtor's debt "in punishment of" a crime committed by someone other than the debtor.

Black's Law Dictionary defines a "violation" as "[a]n infraction or breach of the law." *See Black's Law Dictionary* 1564 (7th Edition 1999). However, the term "violation" is not defined in the Bankruptcy Code or the securities laws. 15 U.S.C. §§ 77b, 78b; 11 U.S.C. § 101. The Department of Securities appears to argue that "violation" means any debt arising under the securities laws. The bankruptcy court in its decision found that the Wilcoxes "innocent victim" defense is of no legal consequence. (*See Appendix pages 570 – 576*). Interpreting "violation" to mean all claims arising under the securities laws or arising out of any litigation which touches on securities laws contravenes several canons of statutory interpretation.

Section 523(a)(19) was added to the Bankruptcy Code to prevent wrongdoers from benefiting from a bankruptcy discharge. "Congress' inclusion of § 523(a)(19) was 'meant to prevent *wrongdoers* from using the bankruptcy laws as

a shield and to allow defrauded investors to recover as much as possible." *In re Lewendowski*, 325 B.R. 700, 704 (U.S.B.C. M.D. Penn. 2005), quoting Legislative History of Title VIII of HR 2673 (emphasis added).

If Congress intended to except from discharge all debts arising under the securities laws then it could have left out the word "violations." By selecting violation Congress is clearly targeting the wrongdoer for denial of discharge.

Therefore, the bankruptcy court's adoption of Department of Securities' interpretation requires the court to invade the domain of the legislative branch by affirmatively disregarding a word selected by Congress. *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978). ("There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted."); *Senator Linie GMBH & Co. KG v. Sunway Line, Inc.*, 291 F.3d 145, 167 (2nd Cir. 2002) (noting even when judicial power is at its apex, courts should not rewrite statutes); *In re Weilein*, 319 B.R. 175 (Bankr. N.D. Iowa 2004) ("Analysis of §523(a)(19) must begin 'with the language of the statute itself.'" *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989) ("When a 'statute's language is plain, the sole function of the courts is to enforce it according to its terms....").

Additionally, the inclusion of the exception in paragraph (A)(ii) of § 523(a)(19) suggests that "violation" cannot mean "all debts arising under the

securities laws." Paragraph (A)(ii) renders nondischargeable any debt that is for fraud, deceit or manipulation in connection with a securities transaction. If all debts arising from claims under federal and state securities laws are nondischargeable pursuant to paragraph (A)(i), it is difficult to discern what independent purpose paragraph (A)(ii) serves. It is not proper to interpret a paragraph in a way that will render another paragraph within the same subsection superfluous. *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) ("[W]e are hesitant to adopt an interpretation of" section 523(a)(6) that would render section 523(a)(9) "superfluous."); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 546, 556-57 (1994) (construing term in a way that would not render another provision superfluous).

Neither does the legislative history support Appellee's interpretation.

First, the Department of Securities ignores the fact that Congress made a decision to narrow the applicability of paragraph (A)(i) of subsection 19 to violations *per se*. In the Senate Bill the original language, which stated

(A) arises under a claim relating to –

(i) the violation of any of the Federal securities laws... [S. REP. NO. 107-146 at 33 (2002)]

was changed in the final Act that became law to:

(A) is for-

(i) the violation of any of the Federal securities laws...[Sarbanes-Oxley Act, Pub. L. No. 107-204, § 803, 116 Stat. 801 (2002).]

This change clearly argues against the Department of Securities interpretation that all debts relating to securities laws are exempt from discharge regardless of whether the debtor himself violated securities law.

Second, the Committee Report stated that subsection 19 was added because "Current bankruptcy law may permit such **wrongdoers** to discharge their obligations under court judgments or settlements based on securities fraud and other securities violations." (Emphasis added) and because "[u]nder current laws, state regulators are often forced to 'reprove' their fraud cases in bankruptcy court to prevent discharge...." [S. REP. NO. 107-146 at 16 (2002)] Under the Department of Securities twisted interpretation, Congress would have to have meant the term "wrongdoers" to include those who committed no "wrongdoing."

Third, § 803 of the CCAA reads "Debts Nondischargeable if Incurred in Violation of Securities Fraud Laws." The Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745, 801, 802 (2002). A review of the surrounding text of the CCAA reveals that no other provision appears on its face to target non-culpable conduct. *Id.* at §§ 801-07.

Lastly, perhaps the most important policy of the Bankruptcy Code is the "fresh start." *Grogan v. Garner*, 498 U.S. 279, 286 (1991) (endorsing fresh start policy of Code); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (acknowledging central purpose of Bankruptcy Act was to provide debtor with new

beginnings). The fresh start ensures that an innocent debtor receives a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt. Due to the importance of the fresh start, the creditor must demonstrate that one of the enumerated exceptions applies even though the creditor was the deserving party outside of bankruptcy. *Grogan, supra*, at 291 (requiring creditor to prove exception applies by a preponderance of evidence); *Century 21 Balfour Real Estate v. Menna (In re Menna)*, 16 F.3d 7, 9 (1st Cir. 1994) ("[T]he claimant must show that its claim comes squarely within an exception enumerated in Bankruptcy Code section 523(a)."). Exceptions to discharge are construed strictly against the Creditor. It is clear that § 523 (a)(19) was designed to close loopholes allowing a debtor who violated the securities laws from receiving a discharge and not to deny a discharge to everyone including the targets of the violation to be denied a discharge. *See, Prime Equity Fund LP v. Lichtman (In re Lichtman)*, 388 B.R. 396 (M.D. Fla. 2008).

Generally, most debts are dischargeable, but if the debt stems from a culpable act personally committed by the debtor, a conduct exception may prevent the debtor from discharging the debt. *Stackhouse v. Hudson (In re Hudson)*, 859 F.2d 1418, 1420 (9th Cir. 1988). These conduct exceptions focus solely on the debtor's conduct. *Rutanen v. Baylis (In re Baylis)*, 313 F.3d 9, 19 (1st Cir. 2002). The ability to discharge debts unless the debt stems from a culpable act personally

committed by the debtor is a fundamental and rarely disturbed policy of the Bankruptcy Code.

Congress could have easily created an exception that would clearly and unambiguously cover all securities debts. There is little evidence that such an exception was what Congress intended. As it would fundamentally change the concept of the fresh start for non-culpable debtors, this Court should not adopt this interpretation.

In this case, the Wilcoxes were investors of the wrongdoer (Schubert). All of the evidence presented in the state court, the bankruptcy court affirmed by the United States District Court by the Department of Securities proved that Schubert was a wrongdoer. (*See* Appendix pages 235 – 288). Schubert plead guilty, she committed the securities violations. The only allegations against the Wilcoxes were that they were investors. They happened to be investors who had received money from Schubert, but there is no evidence that the Wilcoxes were wrongdoers. (*See* Appendix pages 103 – 187). Even the state court judgment merely found that the Wilcoxes had been unjustly enriched. (*See* Appendix pages 459 – 462). There was no finding that the Wilcoxes were violating securities laws or assisting in wrongdoing. *See Oklahoma Department of Securities v. Blair*, 2010 OK 16, ¶ 10; – P. 3rd –. Without wrongdoing by the Wilcoxes, § 523(a)(19) does not come into play and the discharge should not be denied.

The Bankruptcy Court in Colorado has stated:

Essentially, this statute precludes dischargeability if two conditions are met. First, the Plaintiffs must establish that the debt is for violation of securities laws or for fraud in connection with the purchase or sale of a security (the 'Subsection A requirement'). In addition, the debt must be memorialized in a judicial or administrative order or settlement agreement (the 'Subsection B requirement'). If Plaintiffs cannot establish both requirements, their claim will fail.

In re Bahram Amir JAFARI, 401 B.R. 494 (Bkrctcy D. Colo. 2009); *see also*, *MCI Worldcox Network Services, Inc. v. Graphnet, Inc.*, 2005 WL 1116163 at 13 (D. N.J. 2005) (excepts from discharge 'debts arising from judgment ... based upon debtor's violation of certain federal securities laws, state securities laws').

Therefore, both the statutory language, the legislative history and case law strongly indicate that "is for-the violation" of securities laws means a failure of a debtor to abide by the securities laws. Since the Wilcoxes have *not* been found to have committed a "violation" of securities laws, the Department of Securities should not be able to utilize the exception in § 523(a)(19). For these reasons, the Wilcoxes assert the U. S. District Court erred in affirming the bankruptcy court's invoking of § 523(a)(19) to deny the Wilcoxes' discharge.

PROPOSITION II

THE U. S. DISTRICT COURT ERRED IN AFFIRMING THE BANKRUPTCY COURT'S FINDING THAT THERE WAS NO NEED TO PROVE A VIOLATION OF EITHER OKLAHOMA OR FEDERAL SECURITIES LAWS IN ORDER TO DENY THE WILCOXES DISCHARGE UNDER § 523(A)(19) AS THE CONSENSUS OF THE COURTS IS THAT ONLY A DEBT

WHICH RESULTS FROM A VIOLATION BY THE DEBTOR OF SECURITIES LAWS IS NONDISCHARGEABLE.

A. STANDARD OF REVIEW

See Proposition I(A).

B. ARGUMENT

This argument is intended to address Issues 3, 4, 5, 6, 8 and 9 on Appeal set forth above.

It is clear from a review of cases in the various circuits that § 523(a)(19) does not apply to the case at bar because the debt in question was not the result of a securities violation by the Wilcoxes. Department of Securities has not and cannot show that said debt arose from a securities violation or fraud in connection with the purchase or sale of a security, by the Wilcoxes. (*See* Appendix pages 103 – 187 and 459 – 462)

In *Peterman and Reactence, Inc v. Whitcomb (In re Whitcom)*, 305 B.R. 806 (Bankr. N.D. Ill. 2004), the court found that Whitcomb's debt was nondischargeable under 523(a)(19) because Whitcomb's "debt **results from** fraud, fraudulent inducement and fraudulent misrepresentations **made by the Debtor...**" in the sale of securities to the plaintiffs (emphasis added). *Id.* at 810.

In *Barnes v. Jeffrey Michael Dupree (In re Dupree)*, 336 B.R. 520 (Bankr. M.D. Fla. 2005), the court noted "Obviously, Congress intended to design a broad

provision to except from bankruptcy discharge all securities fraud and other securities violations by **'wrongdoers.'**" (emphasis added). *Id.* at 527.

In *Frost, et al.v. Civiello (In re Civiello)*, 348 B.R. 459 (Bankr. N.D. Ohio 2006), the court found that "The judgment **'results from' Defendant's violation** of the securities law identified in the cease and desist order, thereby satisfying the requirement of 11 U.S.C. § 523(a)(19)(B)" (emphasis added). *Id.* at 467.

Analogously, in *MCI Worldcom Network Services, Inc. v. Graphnet, Inc.*, 2005 WL 1116163 (D.N.J. 2005) the court stated "[r]ather, a closer look at the statute reveals that the exception under 11 U.S.C. § 523(a)(19) is not just for any debt that results from a settlement, but only for debts that arise out of a settlement agreement **based upon the debtors violation of federal or state securities laws** (emphasis added)... Because defendant does not argue, nor could it, that the Settlement Agreement here arose from plaintiffs violations of securities laws, this argument too must fail." *Id.* at 12-13. In this case, before this court, while there is no settlement or agreement at issue, the application is clear § 523(a)(19) only applies upon the violation by the debtor of Federal or State Securities Laws.

The consensus of the cases over the last six years in which a court found a debt nondischargeable under Section 523(a)(19), if it arose as a result of the individual debtor(s) committing securities law violations or fraud in connection with the purchase and sale of securities. *See also State of Idaho, Department of*

Finance, Securities Bureau v. Robert O. McClung (In re McClung), 304 B.R. 419 (Bankr. D. Idaho 2004); *Nortman, et al. v. Gordon Sloan Smith (In re Smith)*, 362 B.R. 438 (Bankr. D. Ariz. 2007); *Trucks v. Williams (In re Williams)*, 370 B.R. 397 (Bankr. M.D. Fla. 2007); *Fishbach, et al v. Simon (In re Simon)*, 311 B.R. 641 (Bankr. S.D. Fla. 2004).

In *Shaefer v. Demar (In re Demar)*, 373 BR 232 (E.D.N.Y. 2007) the bankruptcy court dismissed the adversary proceeding in part because the "...plaintiff has not alleged facts that show that the debt was for a violation of federal or state securities laws or regulations." 373 B.R. at 239 (emphasis added).

The clear consensus of these cases is that § 523(a)(19) denies discharge to a debtor who violated the securities laws. The Wilcoxes in this case did not violate the securities laws. The violation was by Schubert and not the Wilcoxes. (See Appendix pages 251 – 288). The only finding by any court (the Oklahoma District Court) was that the Wilcoxes have been unjustly enriched. (See Appendix pages 459 – 462). If Schubert was before the bankruptcy court, then a denial of her discharge would be clear, but Schubert is not the debtor, she, was the architect of the Ponzi scheme that gave rise to this case, the Wilcoxes who put their trust in Schubert like the other investors, are the debtors. The Wilcoxes are not the wrongdoers and therefore § 523(a)(19) is not applicable because the first element is missing. See, *In re Bahram Amir JAFARI*, 401 B.R. 494 (Bkrcty D. Colo. 2009).

In the Oklahoma Supreme Court case recently decided on the Oklahoma District Court case, the Oklahoma Supreme Court recognize the Wilcoxes and other investors as innocent victims of a Ponzi scheme. The Court also recognized the Department of Securities was only seeking restitution from 158 defendants (which included the Wilcoxes) on grounds of unjust enrichment, and fraudulent transfer and that the claim of fraudulent transfer was withdrawn and the Department of Securities was only proceeding against the investors (Wilcoxes) based on unjust enrichment. *Oklahoma Department of Securities v. Blair*, 2010 OK 16, ¶ 1 and ¶ 10; – P. 3rd –.

The Oklahoma Supreme Court goes on to say, "In the trial court the Department explained that it made no allegation that the defendants (Wilcoxes) violated the securities statutes or materially aided in the violation of those statutes." *Oklahoma Department of Securities v. Blair*, 2010 OI 16, ¶ 10; – P. 3rd –.

The Oklahoma Supreme Court did hold that the Department of Securities could proceed against the 158 defendants (Wilcoxes) on equitable grounds for unjust enrichment if the investors received artificially high dividends. The case was reversed and remanded for further proceedings. *Oklahoma Department of Securities v. Blair*, 2010 OK 16, ¶ 30; – P. 3rd –.

For these reasons the Wilcoxes assert that the U. S. District Court erred in affirming the bankruptcy court's denying the Wilcoxes discharge.

PROPOSITION III

THE U.S DISTRICT COURT ERRED IN AFFIRMING THE BANKRUPTCY COURT'S FINDING THERE WAS SUFFICIENT UNDISPUTED FACTS TO ENTITLE THE OKLAHOMA DEPARTMENT OF SECURITIES TO SUMMARY JUDGMENT AS THERE WERE NUMEROUS DISPUTED FACTS CONCERNING THE CULPABILITY OF THE WILCOXES.

A. STANDARD OF REVIEW

See Proposition I(A).

B. ARGUMENT

This Proposition addresses Issue 1 of the Issues on Appeal above. This argument is intended to address Issues 3, 4, 5, 6, 8 and 9 on Appeal set forth above.

In the response to the Department of Securities' motion for summary judgment, the Wilcoxes argued that they had not violated any securities laws and that they were merely investors with Schubert. As part of the Wilcoxes' response to the motion for summary judgment, the Wilcoxes attached their affidavit that they were unaware that Schubert was involved in any illegal activities. Their only involvement with Schubert was as investors in her "day trading" operation. (*See* Appendix pages 144 – 187) The Wilcoxes responses at the very least created a question of fact as to whether the Wilcoxes had violated any securities laws which is a key element for the denial of discharge under § 523(a)(19). Since there was a clear question of fact concerning the culpability of the Wilcoxes summary

judgment by the bankruptcy court was inappropriate and should not have been affirmed by the U. S. District Court. *Celotex Corp. v. Catrett*, 477 U. S. 317 (1986).

VIII. CONCLUSION

Based upon the foregoing the Wilcoxes would pray that this Court would reverse the judgment of the U. S. District Court affirming the bankruptcy court denying dischargeability of the state court judgment against the Wilcoxes. The Wilcoxes would ask that the judgment of the U. S. District Court affirming the bankruptcy court be reversed and the bankruptcy court be instructed to enter judgment on behalf of the Wilcoxes allowing the dischargeability of the state court judgment, or in the alternative, remanding the case for further consideration.

ORAL ARGUMENT

Oral Argument is requested due to the relatively new statute and the litigation on § 523(a)(19) in several circuits.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 16th day of June, 2010, I electronically transmitted the attached document to the Clerk of the Court using the ECF System for filing and I served the attached document by Regular U.S. Mail on the following, who are registered participants of the ECF System:

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I also hereby certify that:

(1) All required privacy redactions have been made and, with the exception of those redactions, every document submitted in Digital Form or scanned PDF format is an exact copy of the written document filed with the Clerk, and;

(2) The digital submissions have been scanned for viruses with the most recent version of a commercial virus scanning program (Symantec AntiVirus, Version 10.1.5.5000, updated 10/04/2007, Revision 20) and, according to the program, are free of viruses.

/s/ Robert N. Sheets

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

 x this brief contains 5513 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

/s/ Robert N. Sheets

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

FILED

FEB 11 2009

GRANT PRICE
CLERK, U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF OKLAHOMA
BY: [Signature] DEPUTY

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel. IRVING L. FAUGHT, Administrator,)

Plaintiff/Appellee,)

vs.)

MARVIN LEE WILCOX and PAMELA JEAN)
WILCOX,)

Defendants/Appellants.)

No. CIV-09-186-D

APPEAL FROM UNITED STATES
BANKRUPTCY COURT FOR THE
WESTERN DISTRICT OF
OKLAHOMA:
CASE NO. BK-07-10610-BH;
ADVERSARY NO. 07-1226-BH

ORDER

Defendants/Appellants Marvin Lee Wilcox and Pamela Jean Wilcox ("Appellants") bring this action to appeal an order of the United States Bankruptcy Court for the Western District of Oklahoma (the "Bankruptcy Court") granting judgment against the Appellants in an adversary proceeding brought in Appellants' Chapter 7 bankruptcy action. In the adversary proceeding, the Bankruptcy Court granted the summary judgment motion of Plaintiff/Appellee the Oklahoma Department of Securities, *ex rel.* Irving L. Faught, Administrator ("Appellee") on Appellee's claim that a debt resulting from an Oklahoma state court judgment against Appellants was not dischargeable in their Chapter 7 bankruptcy action.

Background:

According to the Bankruptcy Order, the undisputed facts reflect that Appellants and others were investors in a securities fraud scheme, described as a Ponzi scheme and a check exchange scheme, operated by Marsha Schubert of Crescent, Oklahoma. Schubert defrauded investors of

more than \$9 million.¹ Pursuant to the Ponzi scheme, instead of investing participants' funds in legitimate investments, Schubert would utilize those funds to pay purported profits to other individuals. Absent the improper use of investor funds, the latter individuals would not have received a profit. In the check exchange scheme, Schubert utilized other individuals' checking accounts to "float" payments to investors as the investors' purported profits. Appellants were among the investors who received payment in the form of purported profits, but consisting of funds belonging to other individuals. They received funds estimated to be in excess of \$500,000.

Appellee brought a state court action pursuant to the Oklahoma Uniform Securities Act, Okla. Stat. tit. 71 § 1-101 *et. seq.*, alleging Appellants and others were liable for unjust enrichment as a result of the funds they received from Schubert. It sought a judgment requiring Appellants to disgorge the profits they allegedly received from the securities scheme. Appellee moved for summary judgment on its unjust enrichment theory, arguing that Appellants should be directed to disgorge any profit they received as a result of the scheme.

The District Court of Oklahoma County ruled in favor of Appellee and against the Appellants and other investors, holding that they were liable on the unjust enrichment theory. Its judgment required Appellants and other investors to disgorge and repay the funds. That decision was appealed, and the Oklahoma Court of Civil Appeals ("Court of Appeals") affirmed the judgment of the state court. A copy of the appellate opinion is included in the instant record on appeal. After the state court entered judgment, Appellants filed a Chapter 7 bankruptcy action; among the debts they sought to discharge in bankruptcy is the state court judgment requiring them to disgorge the profits they received from Schubert.

¹Schubert was convicted of both state and federal crimes based on her fraudulent scheme.

Appellee brought the underlying adversary proceeding, seeking a determination that the state court judgment against Appellants is not dischargeable in bankruptcy because the debt is governed by the exception to discharge set forth at 11 U. S. C. § 523(a)(19). It filed a motion for summary judgment on that issue, and the Bankruptcy Court granted the motion. In doing so, it held that the state court judgment requiring disgorgement of profits gained from a violation of the Oklahoma securities laws, as interpreted by the state court and Court of Appeals, satisfied the requirements of the § 523(a)(19) exception.

Appellants argues the Bankruptcy Court erred because § 523(a)(19) is limited to judgments resulting from the debtor's direct violation of the state securities law, and the Appellants did not directly violate the Oklahoma securities law. Furthermore, Appellants argue, the Bankruptcy Court ignored numerous factual disputes which preclude summary judgment. Appellee contends the Bankruptcy Court correctly interpreted the law; it also notes that the only facts relevant to its determination were found to be undisputed. Thus, any factual disputes that may have been asserted do not preclude a finding on the ultimate issue that the debt was not dischargeable in bankruptcy.

Standard of review:

The legal conclusions or determinations of a bankruptcy court are subject to *de novo* review on appeal to a federal district court. *In re Albrecht*, 233 F. 3d 1258, 1260 (10th Cir. 2000); *In re Herd*, 840 F.2d 757 (10th Cir. 1988). Factual findings are reviewed for clear error, and will be adopted unless clear error is found. *In re Garrett*, 64 F. App'x 739, 740 (10th Cir. 2003)(unpublished opinion) (citing *Turner v. FDIC*, 18 F. 3d 865, 868 (10th Cir. 1994)). Whether a debt is dischargeable under 11 U. S. C. § 523 is a question of law subject to *de novo* review. *In re Troff*, 488 F. 3d 1237, 1239 (10th Cir. 2007).

Analysis:

Although the Bankruptcy Code provides for the discharge of the debtor's debts, certain debts are determined by statute to be excepted from discharge. 11 U. S. C. § 523. In this case, the parties agree that the only exception applicable to the facts is set forth at 11 U. S. C. § 523(a)(19), which provides an exception to discharge of a debt:

(19) that—
(A) is for—

(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

(B) results, before, on, or after the date on which the petition was filed, from —

(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

(ii) any settlement agreement entered into by the debtor; or

(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

11 U. S. C. § 523(a)(19). In its Order, the Bankruptcy Court noted the § 523(a)(19) provisions applicable to this case involve two elements which must be established: 1) a debt that is for a violation of state securities laws; and (2) the debt results from a judgment or order in a federal or state judicial proceeding. Bankruptcy Order at p. 5; *In re Civiello*, 348 B. R. 459, 464 (Bankr. E. D. Ohio 2006).

In this case, Appellants do not argue the state court judgment fails to qualify as a judgment

for purposes of § 523(a)(19). Because the decision is a judgment within the meaning of the statute, that element of § 523(a)(19) is clearly satisfied. Appellants' arguments focus instead on the initial element of the exception, as they contend the debt did not result from their violation of state securities laws. They contend that, as an investor in the Ponzi scheme, they did not violate state law; instead, they assert that they and the other investors are victims of a violation of state securities law by Schubert.

Appellants' arguments regarding the application of Oklahoma securities law to their status as investors were, however, considered and rejected by the state court. The state court rejected Appellants' arguments that they were innocent victims of the Ponzi scheme; its decision applying Oklahoma securities law was affirmed by the Court of Appeals, which held the "defense of being 'innocent victims' has no merit under the facts here. Appellants are in possession of funds which, in equity and good conscience, belong to other investors." Court of Appeals Opinion, ¶ 13.²

In its Order, the Bankruptcy Court noted that the Court of Appeals opinion concluded the Oklahoma Securities Act authorizes the disgorgement of funds received by investors who "directly and pecuniarily benefitted" from the violation of the Act by a third party. Thus, the Bankruptcy Court concluded that the judgment against Appellants and others was made pursuant to Oklahoma securities law, and further noted the Court of Appeals' conclusion that such law does not require wrongful intent, rejecting Appellants' contention that they could not have violated the law because they were innocent victims of the Ponzi scheme. Order, at p. 6.

Because the underlying judgment which created the debt at issue involves only Oklahoma

²To the extent Appellants also argues that the Bankruptcy Court erroneously failed to consider factual disputes regarding their status, the Court disagrees. The Bankruptcy Court correctly focused on the only facts relevant to its decision regarding the applicability of §523(a)(19).

law, the Bankruptcy Court correctly found that this case is controlled by the application of Oklahoma securities law, as “[s]ection 523(a)(19) discharge exceptions are often defined by law external to the Bankruptcy Code.” *In re Lichtman*, 388 B. R. 396, 409 (Bankr. M. D. Fla. 2006). The Bankruptcy Court clearly did not err in relying on the Court of Appeals’ interpretation of Oklahoma securities law as extending to Appellants and authorizing their disgorgement of profits obtained through a violation of the securities law by Schubert. The Bankruptcy Court concluded that the Court of Appeals interpretation of Oklahoma law as extending to Appellants was sufficient to satisfy the § 523 (a)(19) element of a debt resulting from a violation of state securities law, and this Court agrees.

Appellants further argue, however, that § 523(a)(19) cannot apply to the resulting judgment and debt because it did not result from their “violation” of state securities law.

Although Appellants discuss at some length the definition of a “violation” and present authority addressing exceptions to the discharge of a debt in bankruptcy, they offer no authority holding that § 523(a)(19) applies only to a debtor who has been determined to have personally violated state or federal securities law. They correctly note, however, that ““exceptions to discharge are to be narrowly construed, and because of the fresh start objective of bankruptcy, doubt is to be resolved in the debtor’s favor.”” *In re Millikan*, 188 F.App’x 699, 701 (10th Cir. 2006) (unpublished opinion) (quoting *Bellco First Fed. Credit Union v. Kaspar*, 125 F. 3d 1358, 1361 (10th Cir. 1997)).

Notwithstanding the general narrow application of the statutory exceptions to discharge, however, the § 523(a)(19) exception has an express purpose and is broadly construed to achieve that purpose. The exception is designed to be broadly applied because the purpose of that exception is to protect investors and hold accountable those who violate securities laws. *In re Civiello*, 348 B.

R. at 463. As Appellee points out, § 523(a)(19) does not expressly state that the exception is limited to the debtor's personal violation of such laws. Moreover, other subsections of § 523 include language indicating that discharge is limited where certain actions have been taken "by the debtor." Certainly, Congress could have included similar language in § 523(a)(19), but chose not to do so. Further, as Appellee also points out, § 523(a)(19) specifically includes a "disgorgement" order as among the judgment debts which are excepted from discharge under its terms. The statute provides that it extends to "any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor. § 523(a)(19)(B)(iii) (emphasis added). The statute does not expressly state that the payment owed must result from the direct violation of the state law by the debtor, so long as it is owed by the debtor.

In this case, the Court of Appeals held that, under Oklahoma law, a judgment requiring disgorgement of profits gained from a violation of Oklahoma securities laws is not limited only to the individual who actually violated those laws. Instead, disgorgement extends to those who profited or benefitted from the violation by another person. Applying that interpretation of the Oklahoma law underlying the state judgment entered against Appellants, the Bankruptcy Court implicitly found that § 523(a)(19) is not limited to a debtor who has directly violated a state securities law. In extending the statute to Appellants, the Bankruptcy Court applied the Oklahoma Court of Appeals decision; that decision held that Appellants and others who pecuniarily benefitted from a violation of Oklahoma securities law may be directed to disgorge the profits representing that benefit.

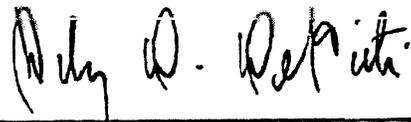
Appellants' arguments do not convince the Court that the Bankruptcy Court erred in its

application of Oklahoma law underlying the judgment and debt which Appellants seek to have discharged in their bankruptcy. The Bankruptcy Court did not err in holding that the Appellee satisfied its burden of proving that, under the exception set forth in § 523(a)(19), the debt involved here is not dischargeable in bankruptcy. Accordingly, the decision should be, and is, AFFIRMED.

Conclusion:

For the foregoing reasons, the decision of the Bankruptcy Court granting summary judgment in favor of Appellee and against the Appellants is AFFIRMED.

IT IS SO ORDERED this 10th day of February, 2010.



TIMOTHY D. DEGIUSTI
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

FILED

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GRANT PRICE
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WESTERN DISTRICT OF OKLAHOMA
BY DEPUTY

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel. IRVING L. FAUGHT, Administrator,)

Plaintiff/Appellee,)

vs.)

MARVIN LEE WILCOX and PAMELA JEAN)
WILCOX,)

Defendants/Appellants.)

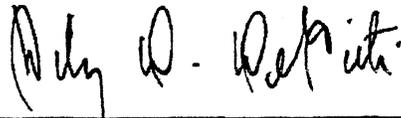
No. CIV-09-186-D

APPEAL FROM UNITED STATES
BANKRUPTCY COURT FOR THE
WESTERN DISTRICT OF
OKLAHOMA:
CASE NO. BK-07-10610-BH;
ADVERSARY NO. 07-1226-BH

JUDGMENT

Pursuant to the Order filed separately herein in which this Court affirmed the decision and judgment of the United States Bankruptcy Court for the Western District of Oklahoma, judgment is hereby entered in favor of Plaintiff/Appellee Oklahoma Department of Securities *ex rel.* Irving L. Faught, Administrator, and against the Defendants/Appellants Marvin Lee Wilcox and Pamela Jean Wilcox on the appeal filed herein by Appellants.

IT IS SO ORDERED this 10th day of February, 2010.



TIMOTHY D. DEGIUSTI
UNITED STATES DISTRICT JUDGE

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