IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

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

REPLY BRIEF 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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INTRODUCTION

The response brief of the Appellee's, Oklahoma Department of Securities (hereinafter referred to as ODS) raises three arguments in their response. First, the ODS argues that the plain language of § 523 (a)(19) does not require that a violation of securities law be committed by the debtor in order to deny the debtor's discharge. Secondly, ODS argues that non-violators who receive proceeds of illegal conduct should be required to disgorge the gains the same as the violator. Finally, the ODS argues that the culpability of the debtor is not a material issue in determining dischargeability as to the debtor.

The facts remain, however, that the district court of Oklahoma county in it's Order of Judgment against the Appellants, Marvin and Pamela Wilcox ("Wilcox") did not make any findings of any violations of any securities law against Wilcox, but merely found that they had been unjustly enriched. (*See* Appendix pages 459 – 462). Additionally, the bankruptcy court in its Memorandum of Decision did not make any findings that Wilcox had violated any securities laws, and in fact, the bankruptcy court stated:

> Although the Defendants strongly argue that they were innocents caught in the web of Schubert's fraudulent scheme, it is of no legal consequence since Oklahoma law does not require wrongful intent. (*See* Appendix pages 570 – 576, page 575).

The bankruptcy court in its findings of fact noted that there were questions of fact in the case and under the bankruptcy court's findings any questions of fact,

concerning the culpability of Wilcox was immaterial. (*See* Appendix pages 570 – 576).

In the case of *Oklahoma Department of Securities v. Blair,* 2010 OK 16, the Oklahoma Supreme Court did acknowledge that there was no finding of any wrongdoing by any of the defendants in the case and characterized them as innocent victims of a Ponzi scheme. The Oklahoma Supreme Court in the *Blair* case also limited the ability of ODS to go against the defendants on equitable grounds for unjust enrichment only if the investors/defendants had received artificially high dividends. (*See Oklahoma Department of Securities v. Blair*, 2010 OK 16 ¶ 1, 10, and 30; — P. 3rd —. Despite the arguments by the ODS, the Supreme Court of Oklahoma, in its opinion, did find differences between the investors of a Ponzi scheme and the perpetrator of a Ponzi scheme when it comes to disgorgement or restitution of funds received.

ARGUMENTS AND AUTHORITIES

PROPOSITION I

THE PLAIN LANGUAGE OF § 523 (a)(19) DOES REQUIRE THAT THERE BE A VIOLATION OF THE SECURITIES LAWS BY THE DEBTOR IN ORDER TO APPLY THE REMIDY OF NON-DISHARGEABILITY.

In their response brief the ODS cites two cases for their proposition that the culpability of the debtor is immaterial. The first case is *Securities Exchange Commission v. Sherman*, 406 B. R. 883 (C.D. Cal 2009), *Appeal Docketed, No. 09-*

*55880 (*9th Cir. June 10, 2009). The Sherman case is interesting in that it is a case where as the judge in the Sherman case indicated, "the experienced bankruptcy judge" held that the debt was dischargeable because § 523 (a)(19) required culpability on the part of the debtor in order to apply the remedy of nondischargeability. In that case, the district court judge reversed the bankruptcy courts decision relying in large part on, *In re Mathews,* No. 07-10108-BH (Bankr. W. D. December 12, 2008). That case is the case decided by the bankruptcy court in the Mathews and Wilcox cases, on appeal before this court. *See Securities Exchange Commission v. Sherman,* 406 B. R. 883 at 886 and, 887.

It should be noted that the Sherman case like the Mathews and Wilcox cases, are presently on appeal awaiting decision.

Secondly, the ODS relies on the case of *Crawford v. Myers*, Case No. 09-11622, Case No. 09-1211 SBB (Bankr. D. Colo. July 20, 2009). As noted in the ODS's response brief, this is an unpublished opinion, and the opinion is a denial of a motion to dismiss with the ruling being that the adversary proceeding would proceed in the bankruptcy court. A review of the docket of that case, however, shows that that case was never finally determined. There was a stipulation of dismissal with prejudice filed on August 12, 2009 due to a settlement between the parties.

In contrast, the Appellants, Wilcox, have cited in their Brief in Chief several cases that, § 523 (a)(19) was designed to close loop holes allowing a debtor who violated securities law from receiving a discharge. *See Barnes v. Jeffrey Michael Dupree* (*In re Dupree*) 336 B. R. 520, 527 (Bankr. M. D. Fla. 2005 ("to except from bankruptcy discharge all securities, fraud and other securities violations by wrongdoers"), and *MCI Worldcom 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, states securities laws....'). In addition, the case of *Mollasgo v. Tills*, 419 B. R. 444 (Bankr. S. D. CA. 2009) states:

> Additionally, the text, associated with section 523 (a)(19) in the Corporate and Criminal Fraud Accountability Act of 2002 (The "Act") supports the interpretation that requires an actual securities violation in addition to the settlement of securities violations and allegations. The Act targets fraudulent actors and the title of § 803 of The Act, which amended section 523 (a) to include sub-section (19) reads: 'Debts Nondischargable If Incurred In Violation Of Securities Fraud Laws' 107 PUB. L. 204, 116 Stat. 745, 801, 802 (2002) (emphasis added). *Mollasgo v. Tills*, 419 B. R. 444 at 451.

> Additionally, in the conclusion of the *Tills* case the court stated:

> Congress intended section 523 (a)(19) to limit the opportunities for those violating securities laws to escape the consequences of their malfeasance. When such a violation occurs, the debt is non-dischargable, notwithstanding its liquidation through litigation, arbitration, or settlement. Having said this, however, non-dischargability is still reserved for those who, in fact, have violated securities laws. *Mollasgo v. Tills*, 419 B. R. 444 at 457. (emphasis added).

Additionally, in the case of *Hodges, et al. v. Buzzeo*, 365 B. R. 78 (Bankr. W.D. Penn. 2007) The bankruptcy court in Pennsylvania found that although both the husband and wife had signed a settlement agreement settling claims of alleged securities laws violations that the plaintiff was only entitled to summary judgment against the husband, Eugene C. Buzzeo, since he was, in fact, a violator of securities laws. The bankruptcy court declined the grant for summary judgment against Janet Buzzeo, the wife, without some finding that she had violated the securities laws.

The ODS in their response brief then goes through a section on congressional intent. In Wilcox Brief in Chief, they also went through congressional intent, and it should be noted that there was a change in the final language of § 523 (a)(19) from violations related to, to violations for. (*See* Appellants Brief in Chief) (emphasis added). It is interesting to note that in the *Sherman* case cited by the ODS, the district court Judge notes "The issue to be decided is whether that section renders non-dischargeable a debt that arises out of the violation of the federal securities laws where the debtor himself did not violate those laws." *Securities and Exchange Commission v. Sherman*, 406 B. R. 883 at 884, (C. D. Cal. 2009). The judge in the *Sherman* case used similar language, which was not adopted in the final version of § 523. The final version, as noted, only allows non-dischargeability for a violation of securities laws.

PROPOSITION II

THE QUESTION OF WHETHER A PARTY IS REQUIRED TO MAKE RESTITUTION OF FUNDS RECEIVED FROM A PONZI SCHEME, AND WHETHER THERE IS A NON-DISCHARGEABILITY OF THAT DEBT IN BANKRUPTCY IS A DIFFERENT ANALYSIS.

In the response brief in their second proposition the ODS goes through a long dissertation of the fact that they can proceed against parties who may be innocent investors in a Ponzi scheme who have received monies. They cite numerous cases in this section, however, each case involved is the question of whether or not the securities commission may seek disgorgement of funds received by a non-violator under the securities laws. *See Securities and Exchange Commission v. Coello*, 139 F. 3rd 674 (9th Cir. 1998); *Securities and Exchange Commission v. Eagan*, 856 F. Supp. 401 (N. D. Ill. 1993); *Securities and Exchange Commission v. Cherif*, 993 F. 2nd 403 (7th Cir. 1991). Each of the cases decided that monies received by innocent investors of a Ponzi scheme, may be required to disgorge or make restitution. None of these cases decided the issue of nondischargeability under the bankruptcy code.

Each of the cases cited deal with the power to go after non-violator defendants to seek disgorgement or restitution, but none of these cases make any decision as to the dischargeability of that debt. As pointed out previously, in Proposition I of this brief, there are several cases that find that there must be a

finding of violations by the debtor in order to achieve the remedy of non-dischargeability. Additionally, the *Blair* case by the Oklahoma Supreme Court limits the ability to seek disgorgement from non-violators to only those who received unusually high dividends. *Oklahoma Department of Securities v. Blair*, 2010 OK 16, — P. 3rd —.

PROPOSITION III

THE CULPABILITY OF THE DEBTOR IS A MATERIAL ISSUE TO BE DECIDED IN THE APPALICABILITY OF NON-DISCHARGEABILITY UNDER § 523(a)(19).

In their response brief, the ODS acknowledges that there have been no findings made that Wilcox have violated the securities laws. In fact, the bankruptcy court in its findings of fact decided that any such facts would be immaterial to the question of non-dischargeability. The question of culpability of the debtor; however, is of primary importance in applying the remedy of non-dischargeability. As pointed out in the Brief in Chief, the question of discharge in bankruptcy and the debtor obtaining a fresh start is the favored position under the code. *Grogan v. Garner*, 498 U.S. 279, 287 (1991).

The language of § 523 (a)(19) clearly states that the denial of discharge is for the violation of any federal or state securities laws. The Code specifically does not state that it is for any order relating to the

violation of any federal or state securities laws. The purpose of § 523 (a)(19) was to close loopholes that allowed a wrongdoer to seek a discharge. *Mollasgo v. Tills*, 419 B. R. 444 (S. D. Cal. 2009) As was found in the *Tills* case in the conclusion, the intent of § 523 (a)(19) gives limited opportunities for those violating securities laws to escape the consequences of their actions and that non-dischargeability is reserved for those who have, in fact, violated securities laws. *See Mollasgo v. Tills*, 419 B. R. 444 at 457 (S. D. Cal. 2009).

In the case of *MCI Worldcom Network Services, Inc. v. Graphnet, Inc.*, 2005 W.L. 1116163, (D. N. J. 2005), the court stated:

> Rather 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 are arise out of a settlement agreement based upon the debtors violation of federal or state securities laws.... (emphasis added). Page 12.

CONCLUSION

Based upon the foregoing, Wilcox would pray that this court would reverse the judgment of the district court affirming the bankruptcy court denying dischargeability of the state court judgment, and instruct that the bankruptcy court to enter judgment on behalf of Wilcox, or in the alternative, remanding the case for further consideration as to the culpability of Wilcox for violations of securities laws.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 12th day of August, 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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(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;

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/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 2637 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

/s/ Robert N. Sheets