

MAR 15 2010

MICHAEL S. RICHIE
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Nos. 104004, 104161, 104262, 105682

IN THE SUPREME COURT OF THE STATE OF OKLAHOMA

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel., IRVING L. FAUGHT, ADMINISTRATOR,) Supreme Court No. 104004
)
Plaintiff/Respondent,) District Court of Oklahoma County
) Judge Patricia Parrish
v.) Case No. CJ-2005-3796
) Consolidated with
ROBERT W. MATHEWS, *et al.*,) Case No. CJ-2005-3299
)
Defendants,)
)
WADE TOEPFER, R. KURT BLAIR, WENDY)
B. BLAIR, NEIL SHEEHAN, ROBERT RAINS,)
)
Defendants/Appellants.)

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel., IRVING L. FAUGHT, ADMINISTRATOR,) Supreme Court No. 104161
)
Plaintiff/Respondent,) District Court of Oklahoma County
) Judge Patricia Parrish
v.) Case No. CJ-2005-3796
) Consolidated with
ROBERT W. MATHEWS, *et al.*,) Case No. CJ-2005-3299
)
Defendants,)
)
KENNETH YOUNG, LESLIE YOUNG,)
K.R. LARUE, DANA LARUE, SCOTT WILCOX,)
SHERYL MERCER, RODNEY MARTIN,)
WANDA MARTIN, RAYMOND LAUBACH,)
DAN JACKSON, and CRYSTAL JACKSON,)
)
Defendants/Appellants.)

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel., IRVING L. FAUGHT, ADMINISTRATOR,) Supreme Court No. 104262
Plaintiff/Respondent,) Consolidated with
v.) Supreme Court No. 104304
ROBERT W. MATHEWS, *et al.*,) District Court of Oklahoma County
Defendants,) Judge Patricia Parrish
KENNETH LARUE, ARTHUR PLATT,) Case No. CJ-2005-3796
YVONNE PLATT, MARVIN WILCOX, and) Consolidated with
PAMELA WILCOX,) Case No. CJ-2005-3299
Defendants/Appellants.)

OKLAHOMA DEPARTMENT OF SECURITIES)
ex rel., IRVING L. FAUGHT, ADMINISTRATOR,) Supreme Court No. 105682
Plaintiff/Respondent,) District Court of Oklahoma County
v.) Judge Vicki Robertson
BARRY AND ROXANNE POLLARD,) Case No. CJ-2005-3796
Defendants/Appellants.) Consolidated with
Case No. CJ-2005-3299

**APPELLEE'S PETITION FOR REHEARING
AND BRIEF IN SUPPORT**

APPEAL FROM THE DISTRICT COURT OF OKLAHOMA COUNTY
ACTION FOR UNJUST ENRICHMENT

March 15, 2010

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Plaintiff/Appellee, the Oklahoma Department of Securities (Department), petitions this Court to rehear this matter and to supplement and clarify the Opinion filed herein on February 23, 2010 (Opinion), pursuant to Okla. Sup. Ct. R. 1.177. The Department contends that there are no legitimate investment profits – reasonable or otherwise – to be shared in a Ponzi scheme. The establishment of an arbitrary rate of return would merely continue the fiction that is a Ponzi scheme. Should this Court agree with the argument set forth below, the undisputed facts in this case support the granting of the summary judgments making it unnecessary for the cases to be remanded to the trial courts and obviate the need for further appeals.

Summary of the Argument

The case at issue differs significantly from the cases referenced by the Court in its determination that the appellant investors should be allowed to show that the money they received was comprised of their principal and a “reasonable dividend” on their investments. As evidenced by the record, the investors herein did not contract for a commercially reasonable rate on the use of their money, but rather gave their money to be used by the Ponzi schemer for options trading and/or day trading wherein the investors would earn profits or incur losses dependent on Marsha Schubert’s skill and luck. In such a speculative endeavor, the investors had no guarantee of an investment profit and any expectation of profit would be counter-balanced by an expectation of loss – either outcome being possible. Asking the trial court to subjectively determine a reasonable investment profit puts that court in the position of restructuring the transaction between the investor and the Ponzi schemer, a result inequitable to the investors who are unlikely to recover their principal investment let alone an arbitrarily established profit.

Further, the Court's holdings are unclear as to whether an innocent investor in a Ponzi scheme who received an unreasonable return on his investment has been unjustly enriched 1) by the entire investment profit received or 2) only by an amount greater than what the trial court decides is a "reasonable" investment profit. The Department contends that when an investor receives a nonexistent "profit" from a Ponzi schemer, the investor should not be entitled to any of that profit.

Background

This case arose from a fraudulent investment scheme orchestrated by Marsha Schubert individually and doing business as Schubert and Associates (collectively, "Schubert). These appeals¹ arose from lawsuits against nominal or relief defendants who had received money from Schubert in the course of her operation of a Ponzi scheme for which the investors gave no reasonably equivalent value and in some cases, no value at all (Relief Defendants). In CJ-2005-3796, the trial court granted summary judgment motions holding that Schubert conducted a Ponzi scheme, that the Relief Defendants were unjustly enriched by the amounts in excess of the principal amounts of their contributions to the Ponzi scheme, and that the Relief Defendants must disgorge the amounts as established in the record. In CJ-2005-3799, the trial court granted a partial summary judgment holding that Schubert conducted a Ponzi scheme, that the Relief Defendants Pollards were unjustly enriched under the Ponzi scheme in an amount to be determined at a later hearing and that the Relief Defendants Pollards are not entitled to the setoffs they claimed.

¹ Supreme Court Cases 104,004, 104,161, 104,262 and 105,682 were consolidated solely for the purposes of adjudication by a single opinion.

On February 23, 2010, this Court issued its Opinion holding that the Department and Receiver had standing to assert their cause of action for unjust enrichment against the Appellants, but reversing the summary judgments and remanding to the district court for consideration of additional facts on the amount owed by each of the individual appellants.

Argument and Authorities

1. There are no legitimate investment profits – reasonable or otherwise – to be shared in a Ponzi scheme.

This Court has ruled that whether a profit in a Ponzi scheme case constitutes unjust enrichment is a mixed question of fact and law and appears to direct the trial courts to focus on the relationship between the investor and the Ponzi schemer rather than the investment activities, or lack thereof, of the Ponzi schemer. As the genesis of its ruling, this Court references a line of cases interpreting fraudulent transfer law that were analyzed by the bankruptcy court in *Daly v. Deptula (In re Carrozzella & Richardson)*, 286 B.R. 480, 488-490 (D. Conn. 2002). However, the *Carrozzella & Richardson* court and the cases it relied on were based on facts that differ from the facts on appeal herein. Particularly, those cases involved the attempted recovery of monies paid to extinguish antecedent debts owed by the Ponzi schemer such as commissions for services performed or interest on loans with contractually fixed stated rates of interest.

In *Carrozzella & Richardson*, the investors received written promises of an annual interest rate of between 8% and 15% for the use of their money in the mid 1980s through early 1990s. *Carrozzella & Richardson* at 483-484. The trial court in *Carrozzella & Richardson* concluded that the contractual relationship between the investor and the Ponzi schemer was in the nature of a debt owed by the Ponzi schemer to the investor. *Id.* at 486. Those interest rates were probably quite reasonable at the time

the loans were made and would not have suggested any irregularity to the lender. The *Carrozzella & Richardson* court concluded that the debtor received value – the forgiveness of a contractual debt – in exchange for the reasonable interest rates for which the investors had contracted. *Id.* at 490-491. See also *Lustig v. Weisz & Associates (In re Unified Commercial Capital)*, 250 B.R. 343 (W.D.N.Y. 2001) (the contracted for annual rate of 12% on a loan was reasonable in the mid 1990s); *Balaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortgage Investment Corp.)*, 256 B.R. 664, 681-682 (S.D.N.Y. 2000) (brokers who provided services to debtor gave value in exchange for commissions paid); and *Solow v. Reinhardt (In re First Commercial Management Group, Inc.)*, 279 B.R. 230, 239 (N.D. Ill. 2002) (brokers provided a service to the Ponzi schemer that was of reasonably equivalent value to the commissions paid). In none of these instances was it unreasonable for the individuals to expect to be paid – the employees for the work they had performed and the lenders for the use of their principal – absent the total failure of the business.

Conversely, the investors herein did not contract with Schubert for a stated rate of return. Rather they gave Schubert money to use for options trading and/or day trading in the hopes that she would make them a profit. Investing in securities inherently involves some level of risk. Investments in business, whether in the nature of equity or debt, can result in loss. There are varying degrees of risk with different investments, yet even investments typically considered as providing safety of principal may lose value. In connection with an equity interest, the investor is hoping that the business venture will be profitable, thereby resulting in an equity interest that increases in value over time. There is no guarantee of profit. When a purported business enterprise is composed of a Ponzi

scheme and nothing more, there are no assets to generate the revenues from which investment returns can be paid. With greater force, when the purpose of the business enterprise is professed to be the speculative enterprises of options trading and/or day trading, expectation of loss is equally as reasonable as the expectation of profit.

The court in *Rieser v. Hayslip (In re Canyon Systems Corp.)*, 343 B.R. 615, 645-646 (S.D. Ohio 2006), quoted at length the analysis set forth in *Carrozzella & Richardson*, yet concluded that the court's reasoning should not apply where an investor invests on the prospect of an implausibly high return rather than a reasonable, market rate of return. The court in *Bayou Superfund v. WAM Long/Short Fund II (In re Bayou Group, LLC)*, 362 B.R. 624, at 635 (S.D.N.Y. 2007), also distinguished the *Carrozzella & Richardson* and *Unified Commercial Capital* cases as involving contractual rights to interest and concluded that the investors in *Bayou Superfund* had no contractual right to fictitious profits. Further, because the *Bayou Superfund* investors had received their principal investment back, there was no present or antecedent debt on which to base a claim for any amount of an investment return. *Id.*

Even the courts that support the *Carrozzella & Richardson* analysis for contractual debt relationships and broker commissions recognize a distinction from situations where an investor is merely expecting to share in profits, if any, from the business enterprise. In *Lustig v. Weisz & Associates (In re Unified Commercial Capital)*, 2002 WL 32500567 (W.D.N.Y. 2002)², the court recognizes a distinction between investors who contract for a reasonable interest rate and those who expect to share in the "hoped for" profits of an enterprise. *Id.* at *8. That court said:

² This is the Western District Court of New York's ruling on appeal of the previously cited bankruptcy decision in *Unified Commercial Capital*.

If a person invests money with the understanding that he will share in the profits produced by his investment, and it turns out that there are no profits, it is difficult to see how that person can make a claim to receive any more than the return of his principal investment. The false representation by the Ponzi schemer that he is paying the investor his share of the profits, which are in fact nothing more than funds invested by other victims, cannot alter the fact that there are no profits to share.

Id. See also *First Commercial Management* at 238 (recognizing an “analytic difference between profits and commission”).

Had Schubert not been operating a Ponzi scheme and actually conducted the options trading and/or day trading as represented, the investors would have shared in any profits or losses generated by Schubert’s trading and would have had no cause of action if their principal had been lost absent misrepresentation or fraud by the trader. But Schubert, by Marsha Schubert’s own admission *was* operating a Ponzi scheme. The Department contends that no profit can result in a Ponzi scheme and that once the investors received back their principal investment there was no antecedent debt on which they could base a claim to any “profits”. At the point each investor’s principal had been returned, Schubert was merely giving money away. The *Carrozzella & Richardson* court stated:

Regardless of the Debtor’s business, legitimate or otherwise, so long as the Debtor received ‘reasonably equivalent value’ in exchange for the transfer of property, there has been no diminution in the Debtor’s estate and the remaining creditors have not been damaged by the transfer. Had the insolvent Debtor simply given away money without an extinguishment of an underlying debt, the situation would be different.

Carrozzella & Richardson at 491. The *Carrozzella & Richardson* court suggests that giving money away without the extinguishment of a debt would not support the court’s ruling as to the Appellants.

2. The establishment of an arbitrary rate of return would merely continue the fiction that is a Ponzi scheme.

As discussed below, the Court's Opinion could be read to require the trial courts to determine a "reasonable investment profit" to which the Appellants are entitled. Where as here, the investors did not contract for a stated rate of return, but rather expected to share in any profits or losses of Schubert's options trading and/or day trading, the trial court would have to arbitrarily set the amount of the investment profit, thus effectively restructuring the transaction between the investor and the Ponzi schemer.

Determining what is a reasonable investment profit in a situation such as this, where the purported underlying investment scheme was itself highly speculative, would be wholly subjective. Investors could argue that they should get the amounts that Schubert represented they had earned on their investments. However, those amounts were baseless, entirely fictitious as well as outrageously unreasonable. Using those amounts would inequitably allow Schubert to decide who gets what as she did in the first instance. Because options trading and day trading are so highly speculative and dependent on the trader's luck and skill, it would be impossible to compare one trader's returns to another's in determining a reasonable investment profit. The Department contends that the courts should not have to engage in the business of restructuring investment agreements or contracts, particularly where as here the speculative nature of the fictitious enterprise would prohibit the formulation of an obvious, equitable and objective rate of return.

3. Clarification by the Court will obviate further appeals.

Within the Opinion, the Court states its ruling in multiple ways making it unclear whether an innocent investor in a Ponzi scheme who received an unreasonable investment profit on the principal amount of his investment has been unjustly enriched 1) by the entire amount of “profit” received or 2) only by an amount greater than what the trial court decides is a “reasonable” investment “profit”. Specifically, the Court’s holding in paragraph 1 seems to differ from the holdings in paragraphs 30 and 52.

Paragraph 1 provides: “We hold that the Department may proceed against the innocent investors to recover *unreasonable* profits received in excess of their investments in the Ponzi scheme.”

Paragraph 30 provides: “We hold that the Department may seek relief against Ponzi investors who received profits that are artificially high dividends. However, we decline to recognize authority by the Department to seek restitution from innocent Ponzi-scheme investors who received their investment with a reasonable interest thereon. Our holding is based on the principle that the Department possesses a public interest in seeking restitution *for investors* who did not receive the return of their initial investment, and that the Department’s unjust enrichment claim is brought against investors who received unreasonable high dividends in a Ponzi-scheme.”

Paragraph 52 provides “Summary Judgment was granted based upon the principle that a profit to a Ponzi-scheme investor is, as a matter of law, unjust enrichment, and subject to an action by the Department for restitution. We have rejected that concept today and explained that equitable recovery against an innocent investor must be based upon that investor’s receipt of an unreasonably high dividend on his or her investment, a mixed question of law and fact that must be decided by the trier of fact on remand.”

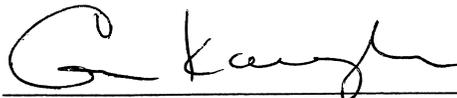
Paragraph 1 suggests that the Department can only seek to recover the “unreasonable” profits earned by an innocent investor in a Ponzi scheme, thereby requiring that the trial court establish some arbitrary amount of profit to attribute to the investor and only allowing the Department to recover some amount greater than that

arbitrarily established amount. The holdings as written in paragraphs 30 and 52 suggest that the consideration of whether an innocent investor has received an unreasonable investment profit goes to the threshold determination of whether the Department has authority to bring a case and that when an investor has received an unreasonable investment profit, the Department may seek recovery of the entirety of the profit.

While the Department recognizes the equitable argument in giving investors who received profits, based on a stated market rate of return, justification to retain those funds, the Department contends that when an investor receives any "investment profit" in a Ponzi scheme, the investor should not be entitled to retain any of the money received in excess of his principal. Receipt of what appears to be an unreasonable investment profit should put the investor on notice that something is wrong in connection with his investment and he should not be entitled to retain any of it at the expense of investors who have not yet recovered the principal amount of their investment.

Conclusion

The Department respectfully asks that this Court reexamine the foregoing points of law and fact. The Department urges the Court to supplement the Opinion of February 23, 2010, and prays for clarification of the ruling to prevent further appeals.



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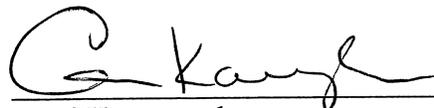
CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the above *Petition for Rehearing and Brief in Support* was mailed this 15th day of March, 2010, by depositing it in the U.S. Mail, postage prepaid, to:

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