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

MARVIN LEE WILCOX and PAMELA JEAN WILCOX,	)	
Debtor,	)	
	)	Case No. CIV-09-186-D
OKLAHOMA DEPARTMENT, OF SECURITIES Ex Rel. IRVING L. FAUGHT,	)	
Plaintiff/Appellee,	)	APPEAL FROM UNITED STATES STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF OKLAHOMA
vs.	)	Adversary No. 07-01226 BH
	)	(BK 07-10610 BH, Chapter 7)
MARVIN LEE WILCOX,	)	
Defendant/Appellant.	)	

APPELLEE'S RESPONSE BRIEF

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA
CASE NO.: BK-07-10610 BH, CHAPTER 7; ADVERSARY NO.: 07-01226 BH

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APPELLEE'S RESPONSE BRIEF

Plaintiff/Appellee, Oklahoma Department of Securities *ex rel.* Irving L. Faught (Department), herein responds to *The Brief and Chief of the Appellants Marvin Lee Wilcox and Pamela Jean Wilcox (Appellants' Brief)*. This appeal arises from an order entered by the United States Bankruptcy Court for the Western District of Oklahoma (Bankruptcy Court) granting summary judgment to the Department against Defendants/Appellants Marvin Lee Wilcox and Pamela Jean Wilcox (Debtors) determining that the debt at issue was non-dischargeable under 11 U.S.C. § 523(a)(19).

ISSUE ON APPEAL

The issue on appeal is whether the Bankruptcy Court properly excepted a debt from discharge under 11 U.S.C. § 523(a)(19) when the violation of the securities laws for which the debt was incurred was conducted by a person other than the Debtors.

The Bankruptcy Court's legal conclusions and determinations are subject to a *de novo* review by this Court. *In re Herd* 840 F.2d 757 (10th Cir. 1988).

STATEMENT OF THE CASE

Between 2001 and 2004, Marsha Schubert, individually and doing business as Schubert and Associates (Schubert), operated a "Ponzi Scheme" in which she promised that funds received from participants would be invested, but instead used the funds to pay purported profits to other participants. To support the "Ponzi Scheme", Schubert engaged in a check kite scheme that created a "float" between several bank accounts through which she could pay purported investment returns.

In October 2004, the Department sued Schubert. In November 2004, an order was entered against Schubert for violations of the Oklahoma Uniform Securities Act of 2004 (Act), Okla. Stat. tit. 71, §§ 1-101 through 1-701 (Supp. 2003), and the Oklahoma Securities Act (Predecessor Act), Okla. Stat. tit. 71, §§ 1-413, 501, 701-703 (1991 & Supp. 2003) (Logan County Order). Schubert subsequently entered guilty pleas in both federal and state criminal cases to charges in connection with the fraudulent scheme and was convicted accordingly.

In connection with the "Ponzi Scheme" and the check kite scheme, Schubert transferred approximately $78,000,000 to Debtors and Debtors transferred approximately $77,000,000 back to Schubert. As a result, Debtors received profits of at least $509,505. In 2005, the Department sued Debtors and others in the District Court of Oklahoma County, Case No. CJ-2005-3796, for disgorgement of the net profits they received from Schubert (Oklahoma County Petition). The Department moved for summary judgment against Debtors asserting that they were unjustly enriched at the expense of other participants in the scheme (Oklahoma County Motion for Summary Judgment). In December 2006, the District Court of Oklahoma County determined that Debtors had been unjustly enriched by Schubert's violations of the Oklahoma Securities laws and ordered Debtors to disgorge the proceeds of that fraud (Oklahoma County Judgment). Debtors have appealed the Oklahoma County Judgment. The Oklahoma Court of Civil Appeals affirmed it and it is now before the Oklahoma Supreme Court.

After Debtors filed for protection under the bankruptcy laws, the Department brought an adversary proceeding against Debtors objecting to the discharge of the debt owed to the Department pursuant to the exceptions to discharge enumerated in 11 U.S.C. § 523(a)(2) and (19). The Department brought a nearly identical adversary proceeding against Robert William Mathews (Debtor Mathews). The two cases were consolidated for purposes of trial.

The Department moved for summary judgment against Debtors Wilcox and Debtor Mathews. The Department asserted that Schubert violated the securities laws of the state of Oklahoma and of the United States by her conduct of the "Ponzi Scheme". The Department also alleged that Debtors and Debtor Mathews violated the Oklahoma securities laws because they materially aided Schubert's violations by allowing their checking accounts to be used in the check kite scheme and actively referring new participants to the Ponzi scheme. Debtors and Debtor Mathews have admitted the factual allegation made by the Department, but deny that they had the state of mind necessary to be found liable for materially aiding the fraud.

The Bankruptcy Court determined, however, that it was not necessary to consider Debtors and Debtor Mathews' level of involvement in the securities fraud to find that the debts are non-dischargeable under 11 U.S.C. § 523(a)(19). The Bankruptcy Court granted summary judgment in favor of the Department finding that there were sufficient undisputed facts to hold that the debts owed to the Department by Debtors and Debtor Mathews are non-dischargeable under 11 U.S.C. § 523(a)(19). The bankruptcy court did not err in denying Appellants' discharge under Section 523(a)(19).

STATEMENT OF FACTS

The Department incorporates Appellants' *Statement of Facts from the Record on Appeal* as set forth in *Appellants' Brief* with the one addition set forth

below. These facts are incorporated solely for purposes of determining the issue on appeal. By incorporating these facts, the Department in no way disclaims any of the facts asserted in the Department's *Motion for Summary Judgment* (*Department's Motion*) or clarified in the Department's *Reply to Defendants' Response to Plaintiff's Motion for Summary Judgment (Department's Reply Brief)*. *See* Designation of Record No. 6, Docket No. 18, *Department's Motion*; and Designation of Record No. 8, Docket No. 20, *Department's Reply*. The Department adds the following fact:

1.) On September 9, 2005, Schubert entered a plea of guilty in the District Court of Logan County, State of Oklahoma, to fourteen (14) counts of obtaining money by false pretenses in connection with the purported investment program (State Guilty Plea). Schubert was sentenced to 25 years in prison and ordered to pay restitution in the amount of Nine Million One Hundred Fourteen Thousand Seven Hundred Forty-Four Dollars ($9,114,744.00) (State Conviction). *State of Oklahoma v. Marsha Kay Schubert,* No. CF-2004-391. Marsha Schubert stated as the factual basis for her plea that she obtained money in a "Ponzi" scheme in which she promised that the funds would be invested but instead, used the funds to pay prior investors involved in the purported investment program. *See* Designation of Record No. 11, Docket No. 24, *Corrected Response to Order, Exhibits 7 and 8.*

ARGUMENT

Proposition I: The plain language of Section 523(a)(19) does not require that the violation of the securities laws be conducted by the debtor.

While the Bankruptcy Code generally favors the interests of the debtor in obtaining a "fresh start," Congress has recognized that there are times when that interest is trumped by the competing interest in protecting the victims of fraud. *Grogan v. Garner*, 498 U.S. 279, 287 (1991). Section 523(a)(19) of the Bankruptcy Code establishes such an exception. Section 523(a)(19) provides, in pertinent part, for the non-dischargeability of a debt 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 of State securities laws; or (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and (B) results 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 damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

Courts have noted that the plain language of Section 523(a)(19) indicates that its coverage is broad. *In re Civiello*, 348 B.R. 459 (Bankr.N.D.Ohio 2006). The legislative history behind Section 523(a)(19) provides that the purpose of this exception to discharge is to protect investors and hold accountable those who violate securities laws. *Id.* at 463. The plain language of Section 523(a)(19)(A)(i)

does not require that the violation of the securities laws necessarily be conducted, directly or indirectly, by the debtor.

The Debtors have focused on attempting to craft a definition for the phrase "for a violation" and suggest that the Department treats that phrase as if it means any debt arising under the securities laws. The Department disagrees that the unjust enrichment judgment against the Debtors simply arises under the securities laws. The Department maintains that the debt directly results from a violation of the securities laws. The Department's Oklahoma County Petition and Oklahoma County Motion for Summary Judgment that underlie the Oklahoma County Judgment clearly state the violations of the Oklahoma securities laws for which the Oklahoma County Judgment issued. *See* Designation of Record No. 11, Docket No. 24, *Corrected Response to Order, Exhibits 9-10, 14-16 and 18.* The Oklahoma Court of Civil Appeals recognized in its order confirming the Oklahoma County Judgment that the debts were for Schubert's violations of the Oklahoma securities laws. *See* Designation of Record No. 11, Docket No. 24, *Corrected Response to Order, Exhibits 19-20.*

As Debtor has pointed out, Congress, when enacting legislation, is presumed to have knowledge of how it has previously used particular terms and how those terms will affect new provisions of the law. *Lorillard v. Pons*, 434 U.S. 575, 581 (1978). Throughout Section 523(a), Congress refers to actions "by the debtor" where it intends to ensure that only the debtor's personal conduct can result in a debt being excepted from discharge. For instance, Congress created an

exception to discharge in Section 523(a)(6) "for willful and malicious injury **by the debtor**"; in Section 523(a)(9) "for death or personal injury caused **by the debtor's** operation of a motor vehicle" while intoxicated; in Section 523(a)(12) "for malicious or reckless failure to fulfill any commitment **by the debtor** to a Federal depository institution's regulatory agency"; and in Section 523(a)(15) for certain domestic obligations "incurred **by the debtor** in the course of a divorce or separation". Even within Section 523(a)(19) Congress uses "by the debtor" to effectively distinguish between judgments entered in judicial proceedings from settlement agreements. In Section 523(a)(19)(B)(ii), a settlement agreement must be "entered into **by the debtor**" to trigger the exception from discharge. However, the plain language of Section 523(a)(19)(B)(i) does not require that the debt at issue result from a judgment or order against the debtor. And, Section 523(a)(19)(B)(iii) specifically provides that the debt at issue may result from a court ordered disgorgement payment owed by the debtor. As clearly stated on the face of the document itself, the Oklahoma County Judgment is a court ordered disgorgement payment owed by the Debtors.

The Logan County Order and Schubert's State Guilty Plea and Conviction satisfy the Section 523(a)(19)(A) requirement that the debt at issue be for violations of securities laws. The Oklahoma County Judgment results directly from the Logan County Order against Schubert for violations of the Oklahoma securities laws and therefore satisfies Section 523(a)(19)(B)(i). Further, the debt owed by Debtors is for court ordered disgorgement of proceeds of the securities

violations committed by Schubert and therefore satisfies Section 523(a)(19)(B)(iii).

Proposition II: Non-violators who receive the proceeds of illegal conduct should be required to disgorge the ill-gotten gains the same as the violator.

It is an established principle in securities laws that disgorgement of ill-gotten gains of a securities fraud can be extended to a non-violator to effect full relief under the securities laws. See *SEC v. Colello*, 139 F.3d 674 (1998); *SEC v. Egan*, 856 F.Supp 451 (N.D. Ill. 1993); *SEC v. Cherif*, 933 F.2d 403, 414 n. 11 (7th Cir. 1991). In *SEC v. Egan*, the court found no meaningful difference between wrongdoers and a third party for purposes of disgorgement: "the deterrence purpose is not dependent on that status—for it is just as important to discourage illegal conduct by taking the proceeds of that illegality from those who have given no current value for the ill-gotten gains that have been turned over to them (even though they themselves have not directly engaged in the illegal activity)." *Egan* at 401.

If the money had remained with the violator and it was the violator that filed for bankruptcy, any debt in connection with that violation would clearly be non-dischargeable. However, violators, in an attempt to hide assets or reward someone who aids their scheme, often transfer their ill-gotten gains to a family member, a favored friend or a close business associate. Allowing that person to keep the ill-gotten gains would in essence benefit the violator.

Proposition III: The culpability of the Debtor is not material to the issue before the Court.

Debtors point to only one question of fact that they claim is still at issue thereby making summary judgment inappropriate. Debtors claim that there is an unresolved question of fact as to whether they personally violated any securities laws. The Department maintains that Debtors violated Oklahoma's securities laws, but acknowledges that as of yet, no finding has been made that they did. However, that question of fact is not material to a determination of the question of law as decided by the Bankruptcy Court. The Bankruptcy Court determined that Schubert's securities law violation triggered the exception, that the Oklahoma County Judgment against Debtors was for Schubert's violation of the securities laws, and that in "equity and good conscience", Debtors should not be allowed to retain the ill gotten funds.

Proposition IV: The Bankruptcy Court did not err in considering the findings of the Oklahoma Court of Civil Appeals.

Debtors Wilcox have appealed the Oklahoma County Judgment so it is not a "final" judgment for purposes of *res judicata*. It follows that the factual and legal conclusions stated in the Oklahoma County Judgment and the opinion of the Oklahoma Court of Civil Appeals are not binding on this Court, however, they can be instructive. There are sufficient facts in the *Record On Appeal* for this Court to conclude that the Oklahoma County Judgment is for Schubert's violation of the securities laws. *See* Designation of Record No. 11, Docket No. 22, *Corrected Response to Order.* Those documents clearly show that but for Schubert's

violations of the securities laws, the Oklahoma County Judgment would not have issued. Further, a review of the case law concerning judgments issued in securities fraud cases for recovery of funds even as against non-violators shows that while the Supreme Court of Oklahoma has not yet ruled on the issues appealed, the order of the Oklahoma Court of Civil Appeals is consistent with other courts across the nation that have considered the issue. *See SEC v. Colello*; *SEC v. Egan*; *SEC v. Cherif*; *Wing ex rel. 4NExchange, L.L.C. v. Yager*, 2003 WL 23354487 (D. Utah 2003); *Chosnek v. Rolley*, 688 N.E.2d 202 (Ind. App. 1997); *Scholes v. Ames,* 850 F. Supp. 707 (N.D. Ill. 1994); *Merrill v. Abbott* (*In re Independent Clearing House Co.*), 77 B.R. 843 (D. Utah 1987); and *Sender v. Buchanan (In re Hedged-Investments Associates, Inc)*, 84 F.3d 1286 (10th Cir. 1996).

Further, it is irrelevant for purposes of determining the exception to discharge under Section 523(a)(19) whether the judgment is final. Section 523(a)(19)(B) clearly provides that the debt may result from a judgment or order issued "before, on or after the date on which the petition was filed."

CONCLUSION

The Department respectfully requests that this Court find that the debt owed by Debtors to the Department is non-dischargeable under 11 U.S.C. § 523(a)(19).

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CERTIFICATE OF SERVICE

I hereby certify that on the 20th of March, 2009, I electronically transmitted the attached document to the Clerk of Court using the ECF System for filing. Based on the records currently on file, the Clerk of Court will transmit a Notice of Electronic Filing to the following ECF registrants:

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