Partners, Inc., 2006 WL 3694629, *1 (W.D. Mich. 2006) (distinguishing between fraud victims and general creditors); *S.E.C. v. Byers*, 637 F. Supp. 2d 166, 184 (S.D.N.Y. 2009) ("The Receiver's proposal to treat differently those involved in the fraudulent scheme when distributions are being made is eminently reasonable and is supported by caselaw."). Further, no specific method of distribution is required; the method of distribution should simply be "fair and equitable." *S.E.C. v. P.B. Ventures*, 1991 WL 269982, *2 (E.D. Pa. 1991). In the end, "[a]n equitable plan is not necessarily a plan that everyone will like." *Credit Bancorp*, 2000 WL 1752979 at *29. Indeed, "when funds are limited, hard choices must be made." *Byers*, 637 F. Supp. 2d at 176 (quoting *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. S.E.C.*, 467 F.3d 73, 84 (2d Cir. 2006)).

Investor Claims from investors who were not on inquiry or actual notice of fraud should be given highest priority. Typically, payment to claimants whose property was unlawfully taken from them, such as investors who had no reason to know of the scheme, is given a higher priority than payment to general creditors. *S.E.C. v. HKW Trading LLC,* 2009 WL 2499146, *3 (M.D. Fla. 2009); *Trade Partners, Inc.*, 2006 WL 3694629 at *1 ("As an equitable matter in receivership proceedings arising out of a securities fraud, the class of fraud victims takes priority over the class of general creditors with respect to proceeds traceable to the fraud."); *see also* III Clark on Receivers § 667 at 1154 (Anderson 3d ed. 1959). This is the appropriate priority because "[t]he equitable doctrine of constructive trusts gives 'the party injured by the unlawful diversion a priority of right over the other creditors of the possessor.'" *Id.* (quoting Clark on Receivers § 662.1 at 1174); *see also S.E.C. v. Megafund Corp.*, 2007 WL 1099640, *2 (N.D. Tex. 2007) (holding that general creditors "will not be paid until all defrauded investors are fully compensated"); *C.F.T.C. v. PrivateFX Global One*, 778 F. Supp. 2d 775, 786-87 (S.D. Tex. 2011) (overruling objection of bank that extended line of credit and adopting receiver's argument that "courts regularly grant defrauded investors a higher priority than defrauded creditors").

In *S.E.C. v. Mutual Benefits Corp.*, Case No. 0:04-cv-60573, Order Granting Receiver's Motion For Final Determination Of Allowed Claims at 3 (S.D. Fla. Oct. 23, 2008), attached as **Exhibit K**, the court identified additional factors that weighed in favor of giving priority to investor claims:

> (1) this is an SEC enforcement action designed to protect the *investors*, not the creditors, (2) [the receivership entity's] fraudulent conduct was directed toward its *investors*, not its creditors (which were paid substantial amounts already), [and] (3) the investors as a whole are less able to bear the financial costs of [the receivership entity's] conduct than are the creditors. . . .

See also Trade Partners, Inc., 2006 WL 3694629 at *1 (noting "there is no evidence that there was an attempt to defraud [the objecting general creditor]"). Each of those factors applies equally here. Nadel focused his fraud on the individuals and entities that invested in the Hedge Funds. The Ponzi scheme depended on their capital infusions to survive, and when the Hedge Funds could no longer attract enough additional investments to cover Nadel's losses, pay bogus gains, return existing investors' funds, or cover other improper diversions of investors' money, the scheme collapsed. In addition, the funds available for distribution by the Receiver consist of proceeds of Nadel's scheme: they mainly consist of False Profits recovered from investors and money the Receiver raised through the sale of property that was purchased or financed with investors' funds. As such, as a matter of equity, defrauded investors should be compensated before general creditors.

Finally, Non-Investor Secured Claimants with allowed claims – *i.e.*, creditors who have a security interest in a Receivership asset in connection with debt owed to that creditor – should receive distributions solely from proceeds of the sale of the asset which secures their interest subject to several limitations. The basis for this treatment of this category of Claimants is detailed in Section II. C. 2. below.

B. The Net Investment Method Is The Proper Method Of Calculating Allowed Amounts For Investor Claims

As indicated above in Section I. B. 1., the Receiver calculated the Allowed Amount of each Investor Claim using the Net Investment Method. As discussed in that Section, the Net Investment Method begins with the calculation of an Investor Account's Net Investment Amount (*i.e.*, the actual dollars the Claimant "invested" in the scheme less any amounts the Claimant already received from the scheme) and does not include any fictitious False Paper Profits. Further, in applying the Net Investment Method, where Claimants have multiple Investor Accounts and one or more of those accounts received False Profits, the accounts are considered on a consolidated basis. For example, if a claimant has one Investor Account in which it invested $100,000 and received distributions of $50,000 and another Investor Account in which it invested $100,000 and received distributions of $125,000, absent application of the Net Investment Method (including consolidated treatment of the accounts), this claimant would have a claim for $50,000. Using the Net Investment Method, the claimant's loss of $50,000 is set-off by the claimant's False Profit of $25,000, resulting in a net claim amount of $25,000. Thus, the Net Investment Method yields the actual difference between how much an investor "deposited" in Nadel's scheme and how much the investor received back from that scheme. This method of calculating a Claimant's loss is equitable and regularly adopted by receivership courts as demonstrated by legal authority cited in the next two subsections.

1. Investor Claimants May Not Recover False Paper Profits

As noted, False Paper Profits should not factor into the determination of an Allowed Amount because they do not reflect actual profits. Rather, they simply reflected numbers made up by Nadel. Using the Net Investment Method, the Allowed Amount only takes into account the actual dollars the Claimant "invested" less any amounts the Claimant already received, regardless of whether it was falsely represented to the Claimant that it had earned profits.

A Ponzi scheme is an illegal endeavor and thus creates no legal entitlement to profits or interest for its investors. *Warfield v. Carnie*, 2007 WL 1112591, *12-13 (N.D. Tex. 2007) (referencing *In re United Energy Corp.*, 944 F.2d 589, 595 (9th Cir. 1991)). As a fraudulent scheme, a Ponzi scheme has no legitimate investment appreciation or interest, and "recognizing profits or other earnings in claims for distribution would be to the detriment of later investors and would therefore be inequitable." *CFTC v. Equity Fin'l Group, LLC*, 2005 WL 2143975, *23 (D.N.J. 2005). Early investors would have the benefit of many more months of False Paper Profits to inflate their claim while more recent investors who lost the same amount of actual dollars would have far less of a claim because they had less time to accumulate those purported profits. Further, if such "paper profits" were recognized, early investors could potentially experience no actual losses as a result of receiving distributions over the years and yet still have a claim to False Paper Profits to the detriment of later investors who did not have the time to recoup their investment or accrue "profits." Early investors should not benefit at the expense of later ones. *See Cunningham v. Brown*, 265 U.S. 1, 13 (1924); *Abrams v. Eby*, 294 F. 1, 4 (4th Cir. 1923); *In re Bernard L. Madoff Inv. Secs. LLC*, 2011 WL 3568936, *5 (2d Cir. 2011) (if Net Investment Method is not adopted "those claimants who have withdrawn funds from their . . . accounts that exceed their initial investments 'would receive more favorable treatment by profiting from the principal investments of those claimants who have withdrawn less money than they deposited, yielding an inequitable result'") (citations omitted). The purported profits or earnings reflected on statements provided to investors were wholly fictitious and arbitrarily determined by Nadel. The Net Investment Method avoids "the absurd effect of treating fictitious and arbitrarily assigned paper profits as real" and avoids legitimizing the scheme. *In re Madoff*, 2011 WL 3568936 at *5.

2. False Profits Received By An Investor Claimant In Connection With An Investor Account Should Set-Off Losses That Investor Suffered In Connection With Another Investor Account

Similarly, for an Investor Claimant who has an Investor Account with losses but received False Profits in connection with another Investor Account, the losses should be set-off with the False Profits. *See Equity Fin'l Grp.*, 2005 WL 2143975 at *12, 26 (upholding Receiver's determination to consolidate accounts). Courts have consistently held that an investor's claim should be limited to the total dollar amount of its investment reduced by any funds it received. *In re Old Naples*, 311 B.R. 607, 616 (M.D. Fla. 2002) (citing *In re C.J. Wright & Co.*, 162 B.R. 597 (Bankr. M.D. Fla. 1993)); *Warfield*, 2007 WL 1112591 at *12-13; *Homeland Communic'ns Corp.*, 2010 WL 2035326 at *3; *Credit Bancorp*, 2000 WL 1752979 at *40; *In re Madoff*, 2011 WL 3568936 at *3-5. As these cases show, this is the most equitable and practical approach for determining investor claim amounts, and a common approach for handling investor claims in a receivership involving a fraudulent investment scheme. *See In re Madoff*, 2011 WL 3568936 at *3-5. As discussed above, netting Investor Accounts held by a Claimant where at least one account received False Profits is necessary under the Net Investment Method and avoids the inequitable possibility of allowing a Claimant to profit at the expense of similarly situated investors. Indeed, in determining which Hedge Fund investors should be sued by the Receiver for False Profits, where applicable the Receiver offset losses and False Profits for investors with multiple Investor Accounts and only sued if the Investor Accounts collectively had a False Profit.

This approach is warranted because any amount a Claimant received in excess of the amount invested in an Investor Account was not the result of any legitimate business or investment activity, but was a fraudulent transfer of funds deposited by new and existing investors. Thus, if a Claimant who received more than the actual dollars invested in connection with one Investor Account is allowed to claim losses in another Investor Account without setting off the profit and the loss, that Claimant will receive a disproportionate share of any distribution. Put differently, to allow investors to retain False Profits while simultaneously recognizing a claim for losses would be inequitable to investors who did not profit in any account. Accordingly, the Net Investment Method as proposed by the Receiver above and as reflected in the Exhibits is the appropriate method for determining Allowed Amounts for Investor Claims.

C. Other Limitations On Claims

1. Limitation On Participation In Any Distribution For Investor Claimant Which Received Inequitable Preference Payment

One Investor Claimant received an inequitable preference payment while it was on notice of red flags associated with the Hedge Funds. (*See* Claim No. 391.) The Claimant invested $2 million dollars in one Hedge Fund in 2005. In June 2008, the Claimant requested a full redemption, and when the funds were not forwarded shortly after the close of the quarter ending September 30, 2008, the Claimant repeated its request. Ultimately, the Claimant sent several letters and emails demanding the return of its investment and reserving its rights to pursue legal remedies. Nadel resisted the Claimant's attempt to withdraw the funds citing "extraordinary market circumstances." In reality, Nadel's scheme was on the brink of collapse, and he could not satisfy the redemption request. Because of the Claimant's persistence, Nadel eventually had no choice but to relent, and the Claimant ultimately agreed to accept $1 million in November 2008 and the balance in January 2009. The Claimant received the $1 million payment merely two months before the scheme collapsed; it did not receive the balance of redemption request. Nadel arranged for this $1 million payment to forestall the immediate detection of his scheme because the Claimant was insisting on a redemption. The $1 million that Nadel transferred to the Claimant was an inequitable preference payment composed of investors' comingled principal investment money. Nadel's initial failure to fund the redemption request and his later agreement to fund it in installments was a clear red flag, so by the time the Claimant received funds it was aware of possible problems.

The U.S. Supreme Court has held that no Ponzi scheme victim may keep a preference. *See Cunningham*, 265 U.S. at 12 (holding "[t]hose who were successful in the race of diligence . . . secured an unlawful preference" and violated "the principle that equality is equity"). Other courts have adopted and applied the Supreme Court's reasoning. *See S.E.C. v. George*, 426 F.3d 786, 799 (6th Cir. 2005) ("The mere coincidence that the [perpetrators] . . . chose the . . . defendant[-investors] (instead of others) to receive funds contributed by other investors in order to delay the discovery of this scheme does not entitle the . . . defendant[-investors] to preferential treatment."); *Elliott*, 953 F.2d at 1570 ("As all of the former securities owners occupied the same legal position, it would not be equitable to give some of them preferential treatment in equity. In fact, the equities weigh against allowing some to benefit from the fortuity that [the scheme's perpetrator] had not sold all of the securities."). Further, the Claimant received "funds contributed by other investors in order to delay the discovery of [Nadel's] scheme," and this "mere coincidence" and fortuitous timing should not elevate it above similarly situated investors. *George*, 426 F.3d at 799.

Because the preference payment transferred to the Claimant 50% of its principal investment, it should not be allowed to participate in any further distributions *unless and until* all Investor Claims recover 50% of their Allowed Amounts. As set forth in **Exhibit D**, to allow the Claimant to receive additional Receivership distributions without such a restriction would give it a greater recovery than other investors and would be inequitable because the Claimant received a preference payment and, in fact, the payment occurred after it learned of red flags. *See id.* ("Hundreds of other investors were victimized by this scheme, yet they will recover only 42 percent of the money they invested, not the 100 percent to which the defendant[-investors] claim to be entitled.”).

2. Limitations On Allowed Amounts For Non-Investor Secured Claimants Who Were Not On Inquiry Or Actual Notice Of Fraud

The only two Non-Investor Secured Claimants who were not on inquiry or actual notice of fraud are BB&T and Bank of Coweta. (Claim Nos. 481 and 482.) As noted in Section I. C. above, each of them loaned money to a Receivership Entity for the purchase of real property and each submitted a claim in connection with the loan asserting a security interest in the real property. The Receiver has no information indicating that either bank had any involvement in or notice of fraud. As such, those claims should be allowed in the amount of the lesser of the principal amount of the loan outstanding (i) at the time of the Receiver’s appointment or (ii) at the time of sale of the underlying collateral, although as detailed below the Claimants only should be paid from the proceeds which may ultimately be recovered from the sale of the collateral less fees and costs incurred by the Receivership to maintain and sell the properties.

a. Non-Investor Secured Creditors Can Only Recover From The Proceeds Of Sale Of Collateral

Courts regularly require that claims of secured creditors, like BB&T’s and Bank of Coweta’s, be satisfied only from the proceeds of the secured collateral. *See Petters*, 2011 WL 281031 at *3 (establishing separate group of creditors, which included banks holding secured loans, each of which received the specific assets assigned to it). If the value of the collateral is insufficient to satisfy the secured creditor’s claim, that creditor may not recover the deficiency from the receivership’s other assets. *See* Clark on Receivers § 660(a) at 1155;

Byers, 637 F. Supp. 2d at 183 (adopting distribution plan which "only permit[ted] secured creditors to recover out of their collateral" and "prohibit[ed] them from recovering under the [p]lan for their deficiency claims"). This rule exists because secured creditors typically enjoy a greater recovery, on a percentage basis, than defrauded investors and general creditors. *Id.* at 183 (quoting *Official Comm. of Unsecured Creditors of WorldCom, Inc.*, 467 F.3d 73 ("[I]t is fair and reasonable that the limited funds available for distribution not be directed to those who have already recovered more than the approximately thirty-six cents on the dollar recovered by general creditors, and rather be used to increase the still-considerably smaller recovery of those covered by the proposed Distribution Plan.")). Indeed, secured creditors have an advantage as they have an identifiable asset over which they enjoy priority in relation to other creditors, including defrauded investors. Accordingly, BB&T's and Bank of Coweta's claims should be paid only out of the proceeds of the sale of their collateral.

b. Non-Investor Secured Creditors' Claims Should Be Subordinated To The Receiver's Recovery Of Fees And Costs Incurred By The Receivership For Maintaining And Selling The Collateral

The Receiver is entitled to compensation for fees and expenses related to managing the properties underlying the secured creditors' claims. In that regard, "an equity receiver does not merely inherit an owner's rights; the receiver is an officer of the court entrusted with administration of the property." *Gaskill v. Gordon*, 27 F.3d 248, 251 (7th Cir. 1994). As a result, "[t]he district court appointing the receiver has discretion over who will pay the costs of the receiver." *Elliott*, 953 F.2d at 1576; *Gaskill*, 27 F.3d at 251 (noting "the district court may, in its discretion, determine who shall be charged with the costs of the receivership"). "The court in equity may award the receiver fees from property securing a claim if the receiver's acts have benefitted that property." *Elliott*, 953 F.2d at 1576; *Gaskill*, 27 F.3d at 251 ("As a general rule, the expenses and fees of a receivership are a charge upon the property administered."). To have "benefitted" a property, the Receiver's acts need not have increased the property's monetary value. *See Elliott*, 953 F.2d at 1577. "Even though a receiver may not have increased, or prevented a decrease in, the value of the collateral, if a receiver reasonably and diligently discharges his duties, he is entitled to compensation." *Id.* (citing *Donovan v. Robbins*, 588 F. Supp. 1268, 1273 (N.D. Ill. 1984) (district court awarded receiver a fee simply for determining how much money to release to creditor)).

Here, the Receiver has reasonably and diligently discharged his duties with respect to the properties underlying the secured creditors' claims. In that regard, the Receiver has paid all applicable taxes on the properties. *See Elliott,* 953 F.2d at 1576-77 ("In most cases, the benefit is easy to determine, such as when the receiver pays taxes on the property. . . ."). Further, the Receiver has maintained both the cottage securing BB&T's interest and the airport facilities securing Bank of Coweta's interest to prevent them from falling into disrepair. With respect to leased properties, the Receiver has also collected rents from the tenants. As such, the Receiver has conferred a benefit on the properties underlying the claims submitted by the secured creditors, and the Receiver is entitled to satisfy his fees and expenses from the proceeds of the sale of the underlying properties before any proceeds are paid to BB&T or Bank of Coweta. *See Elliott*, 953 F.2d at 1576 ("The district court found that it would be inequitable for the burden of the receivership to fall solely on the unsecured investors since the secured investors had substantially benefitted from the Receiver's work."); *Gaskill*, 27 F.3d at 251 ("Courts in equity have allowed liens for receivership expenses to take priority over secured creditors' interests in the property when the receiver's acts have benefited the property.").

c. Non-Investor Secured Creditors' Claim Amounts Should Be Decreased By Interest Purportedly Accrued Since The Receivership's Inception

Like investors who may not recover False Paper Profits, interest, or, more broadly, lost opportunity costs on their "investment", it is not fair or equitable to allow BB&T or Bank of Coweta to recover post-receivership interest on their loans. *Cf. Warfield*, 2007 WL 1112591 at *13 (defendants "could have no reasonable expectation of profiting from an illegal Ponzi scheme"); *S.E.C. v. Forte*, 2010 WL 939042, *5 (E.D. Pa. 2010) ("A receiver's legal entitlement to recover a winning investor's false profits is thus well-settled"). In other words, they should not be entitled to any interest accrued on their loans since inception of this Receivership. Payment of interest would unfairly diminish funds available to pay the claims of innocent defrauded investors.

As discussed above in Section I. C., BB&T loaned $394,000 to a Receivership Entity and has already received payments totaling $79,103.30, representing a recovery to date of 20% of the principal loan amount. Bank of Coweta loaned $1,000,000 and has already received $399,078.75, representing a recovery to date of nearly 40% of the principal loan amount. Considering (i) the amounts these secured creditors have already received – all of which consisted of scheme proceeds; (ii) their ability to absorb losses as compared to a typical investor in this Receivership; and (iii) that the scheme was not directed at them, Claim Numbers 481 and 482 should be allowed only in part and subjected to the limitations set forth in this and the two previous subsections and also reflected in **Exhibit E**. *See Mutual*

Benefits Corp., Case No. 0:04-cv-60573, **Ex. K** at 3 (holding that defrauded investors receive priority because they were the target of fraud and are "less able to bear the financial costs" of such conduct).

D. Claims Which Should Be Denied Because Claimants Were On Inquiry Or Actual Notice Of Fraud

Five Investor Claims and three Non-Investor Claims should be denied because the Claimants were either on inquiry or actual notice of fraud. These claims were submitted by the following: (1) Citco, on behalf of KBC; (2) Think Strategy, as investment manager of the TS Multi-Strat Fund LP; (3) Wachovia Bank; (4) LandMark Bank; and (5) a former Scoop Management employee and Moody family member. (*See* Claim Nos. 446, 447, 448, 473, 476, 500, 501, and 502; **Exs. G** and **H**.)

As previously noted, District Courts sit as courts of equity over federal receiverships. *See, e.g., Elliot*, 953 F.2d at 1566. As such, the Court has "broad powers and wide discretion" to fashion appropriate relief, including in devising a plan for distribution of receivership assets. *See, e.g., id.* In resolving claims submitted in a claims process, courts consider a wide variety of factors with the ultimate goal of fashioning an equitable system that treats similarly situated claimants equally. *See, e.g., Homeland Commc'ns. Corp.*, 2010 WL 2035326 at *2 ("[I]n deciding what claims should be recognized and in what amounts, the fundamental principle which emerges from case law is that any distribution should be done equitably and fairly, with similarly situated investors or customers treated alike. . . .") (quotation omitted); *Cunningham*, 265 U.S. at 13 (as among "equally innocent victims, equality is equity"); *Elliot*, 953 F.2d at 1570 (same). One consideration is whether the claimant acted in "good faith" or, put differently, whether the claimant knew or should have known of fraud. *See, e.g.*, *Megafund Corp.*, 2007 WL 1099640 at *2 (claims disallowed because claimants did not show they acted in good faith).

In pertinent part, the concept of good faith derives from fraudulent conveyance statutes, including the Florida Uniform Fraudulent Transfer Act, Fla. Stats. §§ 726.101 *et seq.* ("**FUFTA**"). Under FUFTA, the Receiver may recover transfers for the benefit of the Receivership estate that were made with "actual intent to hinder, delay, or defraud" creditors (Fla. Stats. § 726.105(1)(a)), which intent is established as a matter of law when a transfer is made during a Ponzi scheme. *See, e.g.*, *In re Christou*, 2010 WL 4008191, *3 (Bankr. N.D. Ga. 2010) ("Any transfers made during the course of a Ponzi scheme are presumptively made with intent to defraud."); *Wing v. Horn*, 2009 WL 2843342 at *4-5 (D. Utah 2009) ("[I]nference of fraudulent intent applies to all transfers from a Ponzi scheme"; categorizing transactions "is inconsistent with fraudulent transfer law's focus on the transferor"); *Quilling v. Schonsky*, 247 Fed. App'x 583, 586 (5th Cir. 2007) ("[T]ransfers made from a Ponzi scheme are presumptively made with intent to defraud . . . ."); *Warfield v. Byron,* 436 F.3d 551, 558 (5th Cir. 2006) (same). FUFTA provides an affirmative defense, however, under which the Receiver may not recover a transfer if the transferee can demonstrate: (1) that it received the transfer in "good faith" and (2) that it provided reasonably equivalent value for the transfer. *See* Fla. Stats. §§ 726.109(1), (2)(b).

Consistent with this equitable principal that claimants who cannot satisfy the good faith standard should have their claims denied, in his "clawback" lawsuits against sophisticated investors who knew or should have known of fraud, the Receiver has tailored his FUFTA claims to require those defendants to show they satisfied the good faith standard.

See, e.g., Wiand, as Receiver v. Buhl, Case No. 8:10-cv-00075-T-17MAP (M.D. Fla.)*; Wiand, as Receiver v. EFG Bank et al.,* 8:10-cv-00241-T-17MAP (M.D. Fla.). Specifically, rather than presuming those defendants acted in good faith, the Receiver has sought to recover all transfers received by them from Nadel's scheme, thus requiring them to prove, *inter alia*¸ their respective good faith before being allowed to keep an amount of distributions equivalent to their principal investment. *See, e.g., Forte*, 2010 WL 939042 at *6 ("If a winning investor should have known [his] or her investment was 'too good to be true,' the court will void the return of principal to that investor. That principal will then be redistributed *pro rata* to all defrauded investors.").

Just as "winning" investors (*i.e.*, investors who received False Profits) who cannot satisfy the good faith standard are not entitled to retain any distributions they received under FUFTA, it would be inequitable to allow Claimants who cannot satisfy the good faith standard to receive distributions of Receivership assets. *See PrivateFX Global One*, 2011 WL 888051 at *9-10 ("Sitting in equity, the district court is a court of conscience.") (quotations omitted); *S.E.C. v. Sunwest Mgmt., Inc.*, 2009 WL 3245879, *9 (D. Or. 2009) ("In approving a plan of distribution in an SEC receivership case, the court must determine the most equitable distribution result for all claimants, including investors."); *Megafund Corp.*, 2007 WL 1099640 at *2 (overruling objection to magistrate's recommendation that claim be denied due to claimant's lack of good faith).

Good faith is an objective standard. *See Terry v. June*, 432 F. Supp. 2d 635, 641 (W.D. Va. 2006). "The relevant inquiry is what the transferee objectively knew or should have known instead of examining the transferee's actual knowledge from a subjective standpoint." *See Quilling v. Stark*, 2007 WL 415351, *3 (N.D. Tex. 2007). "[I]f the circumstances would place a reasonable person on inquiry notice of a debtor's fraudulent purpose, and *diligent* inquiry would have discovered the fraudulent purpose, then the transfer is fraudulent." *In re World Vision Entertainment, Inc.*, 275 B.R. 641, 659 (Bankr. M.D. Fla. 2002). "Importantly, a transferee may not remain willfully ignorant of facts which would cause it to be on notice of a debtor's fraudulent purpose, and then put on 'blinders' prior to entering into transactions with the debtor and claim the benefit of [the good faith defense]." *Id.* (internal citations and quotations omitted). In turn, a diligent inquiry "must ameliorate the issues that placed the transferee on inquiry notice in the first place" and cannot consist of merely inquiring with the transferor about the suspicious circumstances. *In re Bayou Group*, 396 B.R. 810, 846 (Bankr. S.D.N.Y. 2008). In short, if a Claimant's reasonable conduct would have revealed any questions or concerns about any Receivership Entity or Nadel or anyone else associated with a Receivership Entity, that Claimant could not have acted in good faith unless it subsequently conducted a diligent and reasonable inquiry which ameliorated those questions or concerns. Without satisfying these obligations, the Claimant was on inquiry notice of fraud.

All but one of the claims submitted by Claimants on inquiry notice of fraud were submitted by sophisticated financial institutions that, had they acted in a reasonable manner, would have recognized at least some red flags and subsequently would have had to investigate Nadel and Receivership Entities. Had they done so, the institutions would have readily discovered fraudulent conduct. The final claim discussed in this Section was submitted by an employee of a Receivership Entity (who was a member of the Moody family) who also was on inquiry notice of fraud. Given the numerous and easily discoverable red flags, these Claimants did not act in good faith. *See, e.g., In re Pearlman*, 440 B.R. 569, 577 (Bankr. M.D. Fla. 2010) (lenders to Ponzi scheme that ignored red flags did not act in good faith); *S.E.C. v. Basic Energy & Affiliated Res.*, 273 F.3d 657, 660 (6th Cir. 2001) (affirming distribution plan that prohibited defendants from recovering at all, and reduced recovery of employees based on level of involvement in fraudulent scheme).

1. Investor Claimants That Are Sophisticated Financial Companies And Were On Inquiry Notice Of Fraud

As noted above in Section I. E. 5. a., KBC and Think Strategy are sophisticated financial firms which invested in Hedge Funds. KBC has offices around the globe and invested through Citco, another sophisticated global firm. KBC invested in the Hedge Funds in connection with a complex derivative transaction with Think Strategy. KBC advertises that it operates under "the highest professional standards," is provided "support and resources [from its owner, a] leading European banking and insurance group," and its employees are "highly talented." KBC Financial Products, Home, http://www.kbcfp.com/home.html (last visited Oct. 20, 2011). Citco claims it is a global industry leader with more than 5,000 staff in over 44 countries and that it excels in providing hedge fund administration, custody and fund trading, and financial products and corporate planning solutions. Citco, Corporate Overview, http://www.citco.com/#/corporate-overview (last visited Oct. 20, 2011). Think Strategy claims that it "is an asset management firm with a global focus that specializes in alternative investments [and] is the investment manager for several market neutral and multi-strategy hedge funds." Further, it states that its "research department is involved in a continual process of evaluations and due diligence" and it "has over 50 years of combined investment experience." Think Strategy Capital, http://thinkstrategycapital.net/pages/home.php (last visited Oct. 20, 2011).

Clearly, these Investor Claimants were highly sophisticated, experienced, and knowledgeable about investing, reasonable investment practices, and realistic investment performance. Had they acted in a manner that was reasonable and diligent for their sophistication, experience, and knowledge, they would have easily discovered red flags, which in turn would have required them to investigate further, which instead of ameliorating the situation would have uncovered fraudulent conduct. The red flags were numerous and easily discoverable. For example, before perpetrating the scheme, Nadel had been disbarred from the practice of law in New York State for engaging in "dishonesty, fraud, deceit and misrepresentation" by misusing money that had been deposited in his escrow account. That determination was made in a published opinion.

Further, the following relevant information was in the public records of Sarasota County – the same county in which Nadel, the Hedge Funds, and almost all other Receivership Entities were based:

- Nadel had at least eight money judgments entered against him in Sarasota County courts for failure to pay amounts owed; and
- Nadel had gone through a divorce in which in publicly filed documents he: was alleged to have defrauded "numerous individuals and/or businesses;" swore he was a "self employed" "musician" and later unemployed, had monthly gross income of $889.00 and later none, had monthly expenses of $2,894.00, had total assets of $1,650.00 and later of only $1,000.00, and had total liabilities of $129,075.00; and he otherwise represented to the court that he was "financially impoverished" and had "no assets, no liquidity, no money in the bank, and no resources of any kind."

There were also many red flags directly connected to the Hedge Funds and disclosed to investors and potential investors, including the following:

- marketing materials showed the Hedge Funds never reported a single quarter with a negative return;

- the same marketing materials showed the Hedge Funds reported unusually high investment returns - for example, they reported yields between 11.43% and 55.12% per year, and in most years between 20% and 50%;

- for the 79 months during which Victory Fund (one of the Hedge Funds in which Think Strategy invested) was in existence before Think Strategy's investment, that fund only reported one month with a negative return (and at -0.27%, it was barely negative) – in contrast, the S&P index had 31 months of negative returns during the same period;

- for the 110 months during which Valhalla Investment Partners (another Hedge Fund in which Think Strategy invested) was in existence before Think Strategy's investment, that fund only reported four months with negative returns (and at -1.30%, -0.6%, -0.38%, and -0.04%, they were barely negative) – in contrast, the S&P index had 49 months of negative returns during the same period;

- for the 46 months during which Victory Fund (one of the Hedge Funds in which KBC invested) was in existence before KBC's investment, that fund reported no months with a negative return – in contrast, the S&P index had 20 months of negative returns during the same period;

- for the 65 months during which Valhalla Investment Partners (another Hedge Fund in which KBC invested) was in existence before KBC's investment, that fund reported only three months with negative returns (and at -1.30%, -0.6%, and -0.04%, they were barely negative) – in contrast, the S&P index had 32 months of negative returns during the same period;

- the Hedge Funds were not audited; and

- the Hedge Funds' purported accountant had been misidentified as a "CPA" (in reality, his license had been "null and void" since 1989)

> and had been the subject of an investigation and a cease and desist notice from state regulators for improperly identifying himself as a CPA, all of which information was publicly available.

Because these Claimants would have discovered red flags had they acted in a reasonable and diligent manner, they were on inquiry notice of fraud. *In re Old Naples Securities, Inc.,* 311 B.R. at 612-13; *In re Manhattan Inv. Fund Ltd.*, 397 B.R. 1, 23 (S.D.N.Y. 2007) (sophisticated claimant cannot claim ignorance to support its argument that it acted in good faith); *In re M & L Business Machine Co.*, 84 F.3d at 1330, 1339 (10th Cir. 1996) (experienced investor should have realized excessive annual returns as a red flag, and acted in accordance with such information). Accordingly, as also reflected on **Exhibit D**, KBC's and Think Strategy's claims (Claim Nos. 446, 447, 448, 473, and 476) should be denied as it would be inequitable to share Receivership assets with them in light of their failure to act in good faith.

2. Non-Investor Secured Claimant Wachovia Bank Had Inquiry Notice Of Fraud

Wachovia Bank loaned Scoop Real Estate $2,655,000 to purchase a building at 841 South Main Street, Graham, North Carolina which is currently being leased to a Rite-Aid Pharmacy (the "**Rite-Aid Building**"). Wachovia Bank has received payments of interest or principal of $681,050.22 on this loan, representing a 25.65% recovery to date. All of those payments were made with proceeds of the scheme. Wachovia Bank was a well-known bank and part of a financial services company based in Charlotte, North Carolina. In December 2008, Wachovia Bank was acquired by Wells Fargo & Company.

Wachovia Bank was, at a minimum, on inquiry notice of fraud for two independent reasons: (1) because Nadel used a set of "shadow" bank accounts at Wachovia Bank to perpetrate his scheme and to ostensibly conceal it from the staff of the Fund Managers, and those accounts involved a number of improprieties that should have raised numerous red flags at Wachovia Bank; and (2) because Wachovia Bank was an investor in one of the Hedge Funds.

Nadel had been a customer of Wachovia Bank for some time when he opened a set of shadow accounts at Wachovia Bank to commingle money invested in the Hedge Funds and to move it in and out of the Hedge Funds' "official" trading accounts to satisfy redemptions after the close of each calendar quarter. Indeed, because regulatory and contractual considerations prohibited money from being directly transferred between trading accounts, and also for other reasons, Nadel could not have perpetrated the scheme without the Wachovia Bank shadow accounts. Those accounts included not only (1) accounts opened in the name of Scoop Real Estate and Victory Fund which Nadel had authority to do, but also (2) accounts opened in a "doing business as" capacity to mimic the name of the three Hedge Funds for which the Moodys were the principals: Valhalla Investment Partners, Viking Fund, and Viking IRA Fund. Specifically, Nadel was not an officer, director, or principal of these three Hedge Funds and otherwise did not have authority to open accounts on their behalf. As a result, he opened shadow accounts for those funds in the name of "Arthur Nadel dba Valhalla Investments" and "Arthur Nadel dba Viking Fund," as applicable. This alone should have raised red flags because Wachovia Bank knew of the Hedge Funds and Nadel's role, and he had no legitimate reason whatsoever to open two "dba" accounts to mimic names of Hedge Funds. In fact, Nadel was a significant customer for Wachovia Bank and thus had a personal banker who reviewed and managed his relationship with the bank. Further, as discussed below, Wachovia Bank was an investor in Viking Fund and thus was fully aware the Moodys were the principals of that fund and that Nadel was only the purported investment adviser and thus was without authority to open bank accounts on behalf of that fund.

Many other red flags were raised in connection with the shadow accounts. For example, on a quarterly basis Nadel transferred large sums of money between shadow accounts to then funnel money into the Hedge Funds' trading accounts to satisfy redemptions. This was a way to recycle investors' money to pay purported gains and principal redemptions and this repetitive and periodic movement of money through accounts controlled by the same person – Nadel – but held in different names should have raised red flags. As another example, Nadel initiated numerous wires from trading accounts which were accepted into Wachovia Bank shadow accounts that bore an account name that was different from the deposit account name attached to the wires. In other words, Wachovia Bank repeatedly allowed Nadel to deposit money into his shadow accounts even though those deposit wires were made in favor of entities whose names did not match those on the shadow account in which the wire was deposited. This too should have raised red flags. To satisfy its good faith obligations, at a minimum Wachovia Bank should have conducted a reasonable investigation of these matters, which in turn would have uncovered fraudulent conduct. Wachovia Bank, however, did not comply with its obligations and thus did not act in good faith. Indeed, by honoring and executing all of these transactions Wachovia Bank actively helped Nadel perpetrate the scheme and convert and misappropriate scheme proceeds.

Further still, Wachovia Bank was an investor in two Hedge Funds, and thus should have been aware of red flags from that interaction with Nadel and Hedge Funds. Specifically, a related Wachovia Bank entity which acted as a broker/dealer held investments in two Hedge Funds for the benefit of Wachovia Bank in connection with a financial transaction involving Wachovia Bank tied to the returns paid by those Hedge Funds. Those investments were littered with the same red flags discussed above in Section II. D. 1. Additional red flags raised by these investments included:

- for the 63 months during which Viking Fund was in existence before Wachovia Bank's investment, that fund only reported one month with a negative return (and at -0.31%, it was barely negative) – in contrast, the S&P index had 22 months of negative returns during the same period;

- for the 35 months during which Scoop Real Estate was in existence before Wachovia Bank's investment, that fund only reported one month with a negative return (and at -0.25%, it was barely negative) – in contrast, the S&P index had 11 months of negative returns during the same period;

- for the approximately 21 months during which the pertinent investment in Viking Fund was in place, the fund did not report a single month with a negative return – in contrast, the S&P index had 11 months of negative returns during the same period; and

- for the approximately 18 months during which the pertinent investment in Scoop Real Estate was in place, the fund did not report a single month with a negative return – in contrast, the S&P index had 8 months of negative returns during the same period.

Because Wachovia Bank would have discovered red flags had it acted in a reasonable and diligent manner, it was on inquiry of notice of fraud. Accordingly, as also reflected on

Exhibit H, Wachovia Bank's claim (Claim No. 502) should be denied as it would be inequitable to share Receivership assets with it.[20]

3. Non-Investor Secured Claimant LandMark Bank Had Actual Notice Of Fraud

After filing its claims, Claimant LandMark Bank failed and was closed by government regulators on July 22, 2011. Before failing, LandMark Bank provided personal and business banking services in Florida's Sarasota and Manatee Counties, and it had actual notice of fraud at the time it entered into a transaction which underlies one of its claims. Indeed, it knowingly violated orders of this Court in trying to take control of interests in Receivership property. Specifically, on January 3, 2007, LandMark Bank loaned $1,000,000 to Christopher Moody for a personal line of credit (the "**LOC**"). On November 2, 2007, the

[20] At a minimum, if Wachovia Bank's claim is not denied, it should be equitably subordinated to the allowed and allowed in part claims of all other Claimants. "Equitable subordination does not deal with the existence or non-existence of the debt, but rather involves the question of order of payment." *In re Lockwood*, 14 B.R. 374, 380–81 (Bankr. E.D.N.Y. 1981). "The fundamental aim of equitable subordination is 'to undo or offset any inequality in the claim position of a creditor that will produce injustice or unfairness to other creditors. . . .'" *Id.* (quoting *In re Westgate Cal. Corp.*, 642 F.2d 1174, 1177 (9th Cir. 1981)). "Subordination is an equitable power and is therefore governed by equitable principles." *Westgate Cal. Corp.*, 642 F.2d at 1177. "Courts equitably subordinate claims when the claimant has engaged in some type of inequitable conduct and the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant." *Picard v. Katz*, 2011 WL 4448638, *6 (S.D.N.Y. 2011) (internal quotations omitted). "Inequitable conduct encompasses conduct that may be lawful but is nevertheless contrary to equity and good conscience." *Id.* (internal quotation omitted). Courts have applied equitable subordination to instances like this case where claimants seek recovery following the collapse of a Ponzi scheme. *See In re Bernard L. Madoff Inv. Secs. LLC,* 2011 WL 4434632, *19-20 (Bankr. S.D.N.Y. 2011) (holding that in SIPA liquidation, claims of Madoff family members should be subordinated); *Picard*, 2011 WL 4448638 at *6 (holding that "while the Trustee cannot disallow the defendants' claims against the Madoff Securities' estate, he can potentially subordinate them by proving that the defendants invested with Madoff Securities with knowledge, or in reckless disregard, of its fraud").

LOC was increased to $2,000,000. Christopher Moody executed a promissory note for the loan and pledged his interest in his Viking Fund Investor Account, which he held in the name of his revocable trust, the Christopher D. Moody Revocable Trust. The LOC was due on November 1, 2009. Nadel fled on January 14, 2009, and on January 21, 2009, the Commission filed this case and the Receiver was appointed. Christopher Moody notified LandMark Bank's president that Nadel had fled and that the Hedge Funds, including Viking Fund, were worthless. In turn, LandMark Bank's president told Christopher Moody the bank wanted additional security for the LOC. Notably, the bank's chairman of the board and Executive Officer was Christopher Moody's accountant and thus knew that virtually all of Christopher Moody's income came from the Hedge Funds. To satisfy LandMark Bank's request for additional security for the LOC, on or about January 30, 2009, Christopher Moody, as Trustee of the Christopher D. Moody Revocable Trust, purported to pledge to Landmark Bank Bonds.com stock and notes from Bonds.com. Those shares, however, had been purchased with proceeds of the scheme. And Christopher Moody's Bonds.com notes similarly involved loans of funds which were proceeds of the scheme.

LandMark Bank has filed two claims related to the LOC (Claim Nos. 500 and 501). One claim seeks $2,090,488.34 (as of August 19, 2010) purportedly due on the LOC and secured by Christopher Moody's trust's pledged Investor Account with Viking Fund. The other claim asks that the Receiver turnover to LandMark Bank the purportedly pledged Bonds.com interests. Both of those claims should be denied.[21]

[21] At a minimum, if those claims are not denied, they should be equitably subordinated to the allowed and allowed in part claims of all other Claimants. *See supra* n. 20.

a. The Claim Relating To A Loan Secured By Christopher Moody's Trust's Investment In Viking Fund Should Be Denied

As stated above, one of LandMark Bank's claims (Claim No. 500) seeks recovery based on the original security for the LOC, which consisted of Christopher Moody's trust's interest as an investor in Viking Fund. Specifically, the UCC-1 filed by LandMark Bank covers the following collateral: "[a]ll of Debtor's [Christopher D. Moody, as Trustee of the Christopher D. Moody Revocable Trust] right, title and interest in Viking Fund, LLC . . . and also together with all of Debtor's right, title and interest to all dividends or distributions arising there from . . . ." That claim should be denied for two independent reasons: (1) because Christopher Moody's conduct severed his trust's interest in Viking Fund as a matter of equity; and (2) because that interest is worthless as a matter of law.

On January 11, 2010, the Commission instituted an enforcement action against Christopher Moody alleging that he violated antifraud provisions of the federal securities laws in connection with the scheme. *See generally S.E.C. v. Neil V. Moody et al.*, Case No. 8:10-cv-00053-T-33TBM (M.D. Fla.) (the "**Moody SEC Action**"), Compl. (attached as Exhibit A to Doc. 325). On that same day, Christopher Moody, without admitting or denying the allegations in the complaint, consented to entry of a permanent injunction and agreed to disgorge all ill-gotten gains. (Moody SEC Action, Consent of Def. Christopher D. Moody ¶ 3 (Doc. 2, Ex. 1).) On April 7, 2010, a Judgment of Permanent Injunction and Other Relief was entered against Christopher Moody permanently enjoining him from further violations of the antifraud provisions of the federal securities laws. (Moody SEC Action (Doc. 9-1).) In other words, Christopher Moody consented to entry of a judgment that he engaged in securities fraud in connection with the scheme and to disgorge all gains obtained from that scheme.

For purposes of the claims process, as a matter of equity this conduct severed Christopher Moody's (and his trust's) interest in his trust's Investor Account. *See, e.g.*, *Byers*, 637 F. Supp. 2d at 184 ("The Receiver's proposal to treat differently those involved in the fraudulent scheme when distributions are being made is eminently reasonable and is supported by caselaw."); *Basic Energy & Affiliated Res.*, 273 F.3d at 660 (affirming distribution plan that prohibited defendants from recovering at all, and reduced recovery of employees based on level of involvement in fraudulent scheme); *S.E.C. v. Enterprise Trust Co.*, 2008 WL 4534154, *3 (N.D. Ill. 2008) ("Disqualifying those who took the business over the edge is the most common feature, and the least contested aspect, of distribution plans."); *S.E.C. v. Merrill Scott & Assocs.*, 2006 WL 3813320, *6–7 (D. Utah 2006) (excluding from distribution party who referred clients to defendant). Because Christopher Moody and his trust have no interest in his Investor Account, LandMark Bank similarly has no interest in it as its security interest is defined as Christopher Moody's trust's "right, title and interest" in that account and its "dividends and distributions" from that account.

But even setting aside Christopher Moody's culpability, his status as an "insider," and his receipt of tens of millions of dollars of scheme proceeds as "compensation," the claim still should be denied because his Investor Account is not entitled to any distributions in the claims process. As previously noted, during the relevant time all of Christopher Moody's income consisted of scheme proceeds he received as "fees" or from "income" derived from those "fees." As such, all of the money he invested in the pertinent Investor Account consisted of scheme proceeds. In other words, Christopher Moody did not fund his trust's Investor Account with legitimate money; it was funded with scheme proceeds. That is to say, it was funded with fraudulent transfers which the Receiver is entitled to recover for the benefit of defrauded investors. Because the Investor Account was not funded with money to which Christopher Moody was entitled, his (or his trust's) interest in that account is worthless as it is not entitled to any money in this claims process. These circumstances are identical to those faced by the non-profit Claimant discussed below in Section II. F., which received scheme proceeds through the Moody Foundation. Accordingly, as reflected in **Exhibit H**, Claim Number 500 should be denied.

b. The Claim Relating To A Loan Secured By A Purported Pledge Of Bonds.com Interests As Collateral Also Should Be Denied

LandMark Bank's second claim (Claim No. 501) seeks to perfect its claimed interest in Christopher Moody's prior interest in Bonds.com. That claim should be denied for three independent reasons: (1) LandMark Bank had actual notice of fraud at the time it entered into the transaction purportedly giving rise to that claim; (2) that transaction violated the temporary injunction and Order Appointing Receiver in this case; and (3) that transaction involved an avoidable fraudulent transfer. First, the claim should be denied because LandMark Bank had actual notice of fraud before it entered into the transaction underlying this claim. Indeed, LandMark Bank sought the additional security underlying this claim precisely because it learned the then-existing security for the LOC – Christopher Moody's trust's Viking Fund Investor Account – was worthless, Nadel had used Viking Fund and the rest of the Hedge Funds as a scam, Nadel had fled, the Commission had filed an enforcement action to stop a fraudulent scheme involving Viking Fund and the rest of the Hedge Funds, and a receiver had been appointed. Further, LandMark Bank's chairman of the board and Executive Officer was also Christopher Moody's accountant and thus knew that virtually all of the latter's income had come from the Hedge Funds at the center of the Commission's enforcement action. In other words, not only did LandMark Bank request additional security precisely because it was on actual notice of fraud, but its chairman and Executive Officer knew that any other collateral pledged by Christopher Moody – including his interests in Bonds.com – would have been purchased or funded with money Christopher Moody received from the scheme.

Second, the claim also should be denied because the transaction underlying the claim violated both the temporary restraining order ("**TRO**") (Doc. 9) and the Order Appointing Receiver (Doc. 8), both of which were entered on January 21, 2009. Specifically, Christopher Moody's purported pledge of his Bonds.com interests, and LandMark Bank's acceptance of them, violated the TRO because it enjoined Nadel and "any person acting in active concert or participation" with him (like Christopher Moody) "from, directly or indirectly, transferring, setting off, receiving, changing, selling, pledging, assigning, liquidating or otherwise disposing of, or withdrawing any asset or property," including securities, or "drawing from any lines of credit." TRO at 4. It also violated the Order Appointing Receiver because that Order explicitly granted title to "all property, real or personal" of the Hedge Funds and their principals, which included Christopher Moody, to the Receiver. Doc. 8 ¶ 17. Indeed, that grant of title to the Receiver left Christopher Moody with no interest in Bonds.com to pledge to LandMark Bank. The purported pledge nevertheless violated the Order Appointing Receiver because it represented an attempt to directly interfere with the Receiver's "custody, possession, management, and control" of receivership assets. Doc. 8 ¶ 13.

Third, the claim also should be denied because the transaction that forms the basis of the claim was a fraudulent transfer. Nadel caused the Hedge Funds and the Fund Managers to transfer money from the Hedge Funds to Christopher Moody (either directly or through the Fund Managers), including tens of millions of dollars as purported compensation, by grossly misrepresenting trading results and net asset values. Christopher Moody then used that money – which was scheme proceeds – to purchase and fund the equity and debt interests in Bonds.com which underlie this claim. The transfers from the Hedge Funds to Christopher Moody were fraudulent under, *inter alia*, Florida Statutes Section 726.105(1)(a) because they were made from a Ponzi scheme with "actual intent to hinder, delay, or defraud" creditors.[22] *See In re Christou*, 2010 WL 4008191 at *3 ("Any transfers made during the course of a

[22] Because Christopher Moody acquired the Bonds.com collateral using scheme proceeds, the collateral is subject to a constructive trust in favor of defrauded investors. "The doctrine of constructive trusts is a recognized tool of equity designed in certain situations to right a wrong committed and to prevent unjust enrichment of one person at the expense of another either as a result of fraud, undue influence, abuse of confidence or mistake in the transaction." *In re Fin. Fed. Title & Trust, Inc.*, 347 F.3d 880, 891 (11th Cir. 2003) (affirming imposition of constructive trust over homestead property purchased with Ponzi scheme proceeds); *see also Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238, 250-51 (2000) ("Whenever the legal title to property is obtained through means or under circumstances which render it unconscientious for the holder of the legal title to retain and enjoy the beneficial interest, equity impresses a constructive trust on the property thus acquired . . . and a court of equity has jurisdiction to reach the property either in the hands of the original wrongdoer, or in the hands of any subsequent holder . . . .") (internal quotations omitted); *F.T.C. v. Network Servs. Depot, Inc.*, 617 F.3d 1127, 1142 (9th Cir. 2010) ("Importantly, that a transferee was not 'the original wrongdoer' does not insulate him from liability for restitution.").

Ponzi scheme are presumptively made with intent to defraud.") (emphasis added); *Schonsky*, 247 Fed. App'x at 586 ("[T]ransfers made from a Ponzi scheme are presumptively made with intent to defraud . . . .") (emphasis added); *Byron*, 436 F.3d at 558 (same); *S.E.C. v. Harris*, 2010 WL 3719318, *1 (N.D. Tex. 2010) (same). The fact that LandMark Bank received its purported interest in the Bonds.com collateral from Christopher Moody rather than directly from the Hedge Funds does not change the analysis, especially since it provided no value for its receipt of that interest and its receipt of that interest could not have been in good faith as it had actual notice of fraud. *See* Fla. Stats. § 726.109(1)(2)(b) (addressing subsequent transferees and affirmative defenses).

In short, as also reflected in **Exhibit H**, to the extent LandMark Bank received any interests in Bonds.com from Christopher Moody, it would be inequitable to allow LandMark Bank to benefit from those interests at the expense of investors. That is particularly so because LandMark Bank, with the assistance of counsel, knowingly and deliberately tried to take Receivership assets funded with scheme proceeds away from the Receiver's and, ultimately, this Court's control. Accordingly, the Court should deny Claim Number 501.

E. Investor Claims Which Should Be Denied Because Claimant Was An Employee Of A Receivership Entity

The Receiver also received claims from a former employee of a Receivership Entity. (*See* Claim Nos. 474 and 475.) The Claimant was Neil-Moody's step-child, was employed by Scoop Management as a bookkeeper, and was involved in handling certain aspects of the financial affairs of Viking Fund, Viking IRA Fund, Valhalla Investment Partners, Valhalla Management, and Viking Management. The Claimant is also identified as handling the

Investor Account for Receivership Entity Viking Oil & Gas, LLC and Neil Moody's personal account.

During the approximately four years of employment, the Claimant received total compensation of $385,811.32; the Claimant received wages of $118,326.76 in 2008 alone. Receivership Records also indicated the Claimant drove a car paid for by Receivership Entities and had a Receivership Entity credit card. The benefits derived from the car and credit card are not included in the above calculation of compensation. According to Salary.com, the median salary for a bookkeeper in Sarasota, Florida is $45,692. The Claimant's average salary for the approximately four years the Claimant was employed was $96,452.83, which was more than <u>double</u> the median salary. In other words, the Claimant received $385,811.32 (without considering the value of the Receivership Entity car and credit card or that some of the work performed by the Claimant involved Neil Moody's personal affairs) when the typical bookkeeper would have received less than $183,000 for the same time.

These claims should be denied for two independent reasons. First, they should be denied because given the Claimant's disproportionate salary and close relations with investor assets, movement of funds, and Neil Moody's accounting, the Claimant, at a minimum, should have known that something was afoul. A reasonable person under these circumstances would have conducted a diligent inquiry and discovered fraud. As such, the Claimant did not act in good faith. *In re Manhattan Inv. Fund Ltd.*, 359 B.R. at 523-24; *see also In re M & L Business Machine Co*., 84 F.3d at 1339; *Enterprise Trust Co.*, 2008 WL 4534164 at *3 ("Disqualifying those who took the business over the edge is the most common feature, and the least contested aspect, of distribution plans."); *Basic Energy & Affiliated Res.,* 273 F.3d at 660 (affirming distribution plan that prohibited defendants from recovering at all, and reduced recovery of employees based on level of involvement in fraudulent scheme). As such, these claims should be denied.

Second, these claims should be denied even assuming the Claimant acted in good faith because the excess salary received is far more than the $91,987.50 loss claimed by the Claimant. All $385,811.32 the Claimant received as salary from Scoop Management were proceeds of the scheme. Using the median salary from Salary.com, the Claimant only should have earned approximately $183,000 for four years of employment. As such, the Claimant received excess wages of $202,811.32 (of course, this calculation favors the Claimant because it does not take into account the additional benefits provided by the car and credit card or that some of the work performed involved Neil Moody's personal affairs and not Scoop Management "business"). Because no value was provided for the excess wages, the Claimant is not entitled to benefit from them. Indeed, the Receiver is entitled to recover that sum as, at a minimum, a fraudulent transfer. *See In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 682 (Bankr. S.D.N.Y. 2000) ("Fraudulent conveyance law is grounded in equity and is designed to enable a trustee or creditors to avoid a transfer in a transaction where the transferee received more from the debtor than the debtor received from the transferee. The remedy of avoidance seeks to rectify the disparity between that which the transferee gave and that which the transferee got in the transaction. It is this disparity that makes it equitable to require the transferee to repay the excess in value of what he received over what he gave up in the transaction."); *cf. In re Bernard L. Madoff Inv. Sec. LLC,* 2011 WL 4434632, *12

(Bankr. S.D.N.Y. 2011) ("The Defendants unsuccessfully argue that their services constituted reasonably equivalent value and fair consideration given to BLMIS in exchange for their salaries."). As such, it would be inequitable to allow the Claimant to retain the gross overpayment of wages and also assert a claim for investment losses. As reflected in **Exhibit G**, Claim Numbers 474 and 475 should be denied for these reasons.

F. Investor Claim Which Should Be Denied Because Principal Investment Was Made With Proceeds Of The Scheme

A charitable organization submitted a claim based on losses it purportedly sustained when it invested scheme proceeds it received from the Moody Foundation as donations in a Hedge Fund. That claim should be denied because the Claimant had no right to those funds in the first place. Specifically, between April 26, 2004, and November 21, 2008, Neil Moody, through his Moody Foundation, transferred $1,219,222.00 to the Claimant in numerous installments as donations. The donations consisted of scheme proceeds that Nadel caused Hedge Funds and Fund Managers to transfer from the Hedge Funds to Neil Moody, including tens of millions of dollars transferred as purported compensation, by grossly misrepresenting trading results and net asset values. In turn, Neil Moody transferred some of that money to the Moody Foundation. Neil Moody conditioned the donations on the Claimant's investment of that money in one of the Hedge Funds, and the Claimant "invested" $1,111,111.40 of those donations in Valhalla Investment Partners and received $30,315.90 in distributions from that "investment." The Claimant filed a claim for $1,080,795.50, its Net Investment Amount. (*See* Claim No. 478.)

The Claimant, however, did not invest its own money in the scheme. Rather, it reinvested scheme proceeds which it received as donations. The initial transfers from the

Hedge Funds to the Moody Foundation through Fund Managers and Neil Moody were fraudulent transfers under, *inter alia*, Florida Statutes Section 726.105(1)(a) because they were made from a Ponzi scheme and thus with "actual intent to hinder, delay, or defraud" creditors. *See In re Christou*, 2010 WL 4008191 at *3 ("Any transfers made during the course of a Ponzi scheme are presumptively made with intent to defraud."); *Schonsky*, 247 Fed. App'x at 586 ("[T]ransfers made from a Ponzi scheme are presumptively made with intent to defraud . . . ."); *Byron*, 436 F.3d at 558 (same); *Harris*, 2010 WL 3719318 at *1 (same); *see also In re Bayou Group, LLC*, 439 B.R. 284, 306 n.19 (S.D.N.Y. 2010) ("[W]here a Ponzi scheme exists, there is a presumption that transfers were made with the intent to hinder, delay and defraud creditors . . . ."); *Terry*, 432 F. Supp. 2d at 639-40 (same); *In re Fin. Resources Mortg., Inc.*, 2011 WL 2680878, *11 (Bankr. D.N.H. 2011) (same); *Quilling v. Stark*, 2006 WL 1683442, *6 (N.D. Tex. 2006) (same); *In re Madoff*, 440 B.R. at 255 (same).

That the Claimant was a subsequent transferee – *i.e.*, that it did not receive the transferred money directly from the Hedge Funds but rather through the Moody Foundation – does not change the analysis. *See* Fla. Stats. § 726.109. If the Claimant had not reinvested the majority of the funds that it received, the Receiver would have instituted a "clawback" action against it, as the Receiver has done against other organizations that received fraudulent transfers as charitable contributions. *See, e.g., Wiand, as Receiver v. Bishop Frank J. Dewane*, Case No. 8:10-cv-246-T-17MAP (M.D. Fla.); *Wiand, as Receiver v. Sarasota Opera Assoc., Inc.*, Case No.: 8:10-cv-248-T-17MAP (M.D. Fla.). Indeed, the Receiver has a claim against the Claimant to recover approximately $138,426.50, which represents money

(1) the Claimant received from the Moody Foundation and did not reinvest in the scheme and (2) the Claimant took as distributions from its "investment."

The Claimant cannot satisfy the affirmative defense to a fraudulent transfer claim provided by Florida Statutes Section 726.109, which requires it to demonstrate that (1) it received the transfers in "good faith" <u>and</u> (2) that it provided equivalent value for the transfers. *See* Fla. Stats. §§ 726.109(1), (2)(b). Specifically, the Claimant did not provide anything of value to the Hedge Funds in exchange for the donations – hence, their characterization as "charitable donations" – so they are avoidable fraudulent transfers regardless that the Claimant is a charitable organization. *See Scholes v. Lehman*, 56 F.3d 750, 761 (7th Cir. 1995) ("The statute makes no distinction among different kinds of recipient of fraudulent conveyances. Every kind is potentially liable."); *Hecht v. Malvern Preparatory Sch.*, 716 F. Supp. 2d 395, 402 (E.D. Pa. 2010) (holding that receiver was entitled to recover donation made with funds of innocent investors in Ponzi scheme); *In re C.F. Foods, L.P.*, 280 B.R. 103, 111 (Bankr. E.D. Penn. 2002) ("In perpetrating the Ponzi scheme, [the perpetrator] had to know that the monies from investors would eventually run out and that the payments to charities would contribute to the eventual collapse of the stratagem. Knowledge that future investors will not be paid is sufficient to establish actual intent to defraud them."). Because the Claimant did not invest money that it had a right to receive or keep, its Claim Number 478 should be denied as reflected on **Exhibit G**.

III. ALL ASSETS AND LIABILITIES OF THE RECEIVERSHIP ENTITIES SHOULD BE POOLED TO FORM A SINGLE RECEIVERSHIP ESTATE

A. Factual Basis For Pooling Assets And Liabilities

From 1999 through 2008, approximately $330 million was raised from approximately 687 investors on behalf of one or more of the Hedge Funds by Nadel and his entities, Scoop Management and Scoop Capital; by the rest of the Fund Managers; and by the Moodys through the offer and sale of securities in the form of interests in Hedge Funds as part of a single, continuous Ponzi scheme. The Receiver discovered that, although the Receivership Entities referred to separate Investor Accounts in communications with investors, in reality physically separate accounts did not exist. All investor funds were commingled in Nadel's and the Receivership Entities' financial accounts, regardless of with which Receivership Entity the money had been invested.

Nadel grossly overstated the trading results of the Hedge Funds. Despite only trading a very small portion of the money purportedly under management and achieving significantly lower, and typically negative yields (*i.e.*, trading losses) on those trades, Nadel, the Moodys, and the Fund Managers falsely communicated to investors and potential investors, through monthly "statements," Hedge Funds' "Executive Summaries," and other communications, that investments were generating positive returns and yielding between 10.97% and 55.12% per year. For most years, they falsely represented the investments were generating returns between 20% and 30%. In reality, overall the Hedge Funds experienced trading losses.

To perpetrate and perpetuate this scheme, Nadel caused the Hedge Funds to pay investors "trading gains" as reflected on their false monthly statements. The funds used to pay these purported trading gains were not generated from trading activities; rather they were generated from new or existing investors. Nadel further caused the Hedge Funds to pay more than $95 million in "fees." Those fees were based on grossly inflated returns and thus were improperly and wrongfully paid. The negative cash flow of the Hedge Funds made the eventual collapse of the scheme inevitable.

Here, pooling all Receivership Entities' assets is appropriate because Nadel operated the Hedge Funds as part of a single, continuous Ponzi scheme, and all of the other Receivership Entities were acquired or funded with money that Nadel improperly diverted from the Hedge Funds. Further, Nadel treated the Hedge Funds as a single source of money, and the investors' money was commingled in the Hedge Funds' accounts and other accounts controlled by Nadel, especially in and through accounts he controlled at Wachovia Bank, including the shadow accounts discussed above in Section II. D. 2. Specifically, Nadel moved money raised from investors in the different Hedge Funds in, out, and between those accounts and also between those accounts and the Hedge Funds' trading accounts as necessary to satisfy redemptions and quarterly transfers of purported "profits" to investors. To the extent Nadel traded money, he did so in a pooled and commingled fashion through a single master trading account. Specifically, when trading, Nadel would pool all available money raised from investors and money in personal or other non-Hedge Fund accounts that he controlled into a single account, which he used to purchase securities. Then, after the close of the trading session, Nadel allocated the completed trades as he wished among the pooled accounts.

Consistent with legal authority discussed in the next Section, Nadel's treatment of the Receivership Entities and of investors' money in the manner described in the previous paragraphs warrants pooling all assets of the Receivership Entities. Specifically, all money and other assets that constitute Receivership assets, regardless of how they were previously allocated, should be held to constitute one fund and used in a collective manner to pay the collective liabilities of the Receivership Entities, in accordance with the plan discussed in this Motion.

In the absence of an order pooling the assets and liabilities into one Receivership estate, the Receiver would have to separately administer claims to assets held by each of the Receivership Entities. In addition to being inconsistent with Nadel's treatment of those entities, this would be a time-consuming, costly, and to a large extent, arbitrary task. Separate administration of each Receivership Entity's claims would require the Receiver to (1) apportion administrative costs among the Receivership Entities, (2) apportion third-party recoveries among the Receivership Entities, and (3) separately distribute the remaining assets from each entity. Essentially, trying to separately administer each entity would require the Receiver to force an order upon each Receivership Entity when none existed. The end result could be that some Claimants would receive a greater recovery simply because it was falsely represented to them that they were investing with a particular Receivership Entity instead of another one. Pooling the assets and liabilities of the Receivership Entities is the most cost-effective and equitable approach, and is warranted by the facts.

B. Legal Basis For Pooling Assets And Liabilities

Treating all Receivership assets as a single fund to pay all collective liabilities of the Receivership Entities benefits all Claimants and, as noted in the previous Section, is consistent with the manner in which Nadel operated those entities. Further, this requested relief is well within the Court's broad power to administer this Receivership. *See Elliott*, 953 F.2d at 1566 ("The district court has broad powers and wide discretion to determine relief in an equity receivership. . . . This discretion derives from the inherent powers of an equity court to fashion relief . . . ."); *HKW Trading LLC,* 2009 WL 2499146 at *2; *see also S.E.C. v. Hardy*, 803 F.2d 1034, 1040 (9th Cir. 1986); *Basic Energy & Affiliated Resources, Inc.*, 273 F.3d at 668. The primary purpose of an equity receivership is to promote the orderly and efficient administration of the estate for the benefit of the creditors. *See Hardy*, 803 F.2d at 1038. Consolidating all of the assets and liabilities of the Receivership Entities best serves this purpose.

Courts routinely permit equity receivers to pool assets. *See, e.g.*, *HKW Trading*, 2009 WL 2499146 at *6 ("The Court directs that all assets and liabilities of the Receivership Entities be consolidated for all purposes."); *S.E.C. v. Credit Bancorp, Ltd.*, 290 F.3d 80, 91 (2d Cir. 2002) (affirming district court's equitable authority to treat all fraud victims alike and order *pro rata* distribution of assets); *Basic Energy*, 273 F.3d at 663 (adopting receiver's plan to create single pool of assets for all investors); *Elliott*, 953 F.2d at 1584 (approving district court's decision to reject tracing and treat three companies as single entity); *S.E.C. v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 332 (5th Cir. 2001) (affirming district court's order approving receiver's plan to distribute funds to all Claimants on *pro rata* basis even though funds invested by two claimants were segregated by fraudster and traced to separate account); *CFTC v. Topworth Int'l, Ltd.*, 205 F.3d 1107, 1115-16 (9th Cir. 1999) (affirming district court's adoption of receiver's plan to treat three companies involved in scheme as one for purposes of paying claims because each entity appeared to be alter ego of the other);

Quilling v. Trade Partners, Inc., 2008 WL 4283359, *4 (W.D. Mich. 2008) ("In [r]eceivership cases where the fraud has features that are similar or common to all victims, and at least some commingling of funds occurred, pro rata distribution of pooled assets has been the standard. . . . "); *S.E.C. v. Amerifirst Funding, Inc.*, 2008 WL 919546, *5 (N.D. Tex. 2008) (concluding "the most equitable approach is to pool the assets" of three receivership entities and distribute funds on *pro rata* basis even in absence of specific instances of commingling because entities were used similarly to further fraudulent scheme); *U.S. v. Durham*, 86 F.3d 70, 72-73 (5th Cir. 1996) (approving receiver's plan to distribute money to claimants on *pro rata* basis even though majority of money could be traced to one claimant); *see also U.S. v. Real Property Located at 13328 & 13324 State Hwy.*, 89 F.3d 551, 553 (9th Cir. 1996) (approving district court's finding that "[i]nstead of engaging in a tracing fiction, the equities demand that all [defrauded] customers share equally in the fund of pooled assets in accordance with the SEC plan").

Indeed, courts have held that "*any* comingling is enough to warrant treating all the funds as tainted." *Byers*, 637 F. Supp. 2d at 177. Because "money is fungible" it is "impossible to differentiate between 'tainted' and 'untainted' dollars. . . ." *S.E.C. v. Lauer*, 2009 WL 812719, *4-5 (S.D. Fla. 2009). "Once proceeds become tainted, they cannot become untainted." *United States v. Ward*, 197 F.3d 1076, 1083 (11th Cir. 1999). In addition, "when tainted funds are used to pay costs associated with maintaining ownership of [a] property, the property itself and its proceeds are tainted by the fraud." *Lauer*, 2009 WL 812719 at *3 (citing *United States v. One Single Family Residence Located at 15603 85th Ave. North, Lake Park, Palm Beach County, Fla.*, 933 F.2d 976, 982 (11th Cir. 1991)).