11-1516-cv(L)

11-1517-cv(con), 11-1738-cv(con), 11-1741-cv(con), 11-1859-cv(xap), 11-1879-cv(xap)

United States Court of Appeals

for the

Second Circuit

COMMODITY FUTURES TRADING COMMISSION,

Plaintiff-Appellee-Cross-Appellee,

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

ROBB EVANS & ASSOCIATES LLC,

Receiver-Appellee-Cross-Appellee,

KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION,

Interested Party-Appellee-Cross-Appellant,

(Caption Continued on Inside Cover)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF RECEIVER-APPELLEE-CROSS-APPELLEE IN ANSWER TO PRINCIPAL BRIEF OF CROSS-APPELLANT KCERA

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v.

3M EMPLOYEE WELFARE BENEFIT ASSOCIATION TRUST I, 3M EMPLOYEE WELFARE BENEFIT ASSOCIATION TRUST II, 3M EMPLOYEE WELFARE BENEFIT ASSOCIATION TRUST III, MINNESOTA MINING AND MANUFACTURING EMPLOYEE RETIREMENT INCOME PLAN TRUST, BLUE CROSS AND BLUE SHIELD ASSOCIATION NATIONAL RETIREMENT TRUST, NORTH DAKOTA STATE INVESTMENT BOARD, SACRAMENTO COUNTY EMPLOYEES' RETIREMENT SYSTEM, SAN DIEGO COUNTY EMPLOYEES RETIREMENT ASSOCIATION, KAISER ALUMINUM & CHEMICAL CORPORATION ASBESTOS PERSONAL INJURY TRUST, ALEXANDER DAWSON FOUNDATION, ALEXANDER DAWSON, INC.,

Interested Parties-Appellants-Cross-Appellees,

ACUMENT GLOBAL TECHNOLOGIES, INC., WELLS FARGO & CO. MASTER PENSION TRUST; CBS MASTER TRUST; CARNEGIE MELLON UNIVERSITY, H-E-B BRAND SAVINGS & RETIREMENT PLAN TRUST, HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM, OHIO NORTHERN UNIVERSITY, THE TIMKEN COMPANY COLLECTIVE INVESTMENT TRUST FOR RETIREMENT TRUSTS; UNIVERSITY OF PITTSBURGH - OF THE COMMONWEALTH SYSTEM OF HIGHER EDUCATION, VULCAN MATERIALS COMPANY,

Interested Parties-Appellees-Cross-Appellees.

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Receiver-Appellee Robb Evans & Associates LLC (the "Receiver") is a California limited liability company. No publicly held entity is affiliated with the Receiver, and no publicly held corporation owns ten percent or more of the Receiver.

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I

STATEMENT OF ISSUES

Robb Evans & Associates LLC (the "Receiver") respectfully submits that there are two issues on the cross-appeal filed by the Kern County Employees' Retirement Association ("KCERA"):

1. Whether the District Court abused its discretion in entering an order (the "Distribution Order), which determined that the Receiver's proposed *pro rata* plan of distribution, without an inflation adjustment, was fair and reasonable; and

2. Whether the cross-appeal should be dismissed on the grounds that it is moot in light of the fact that KCERA failed to obtain a stay of the Distribution Order and it has now been fully executed.

II

STATEMENT OF THE CASE AND SUMMARY OF THE RECEIVER'S FINDINGS

Pursuant to Rule 28(i) of the Federal Rules of Appellate Procedure, the Receiver adopts by reference the statement of the case and summary of the Receiver's findings set forth in its brief in answer to the brief of the WGTC Appellants.

III

STANDARD OF REVIEW

The appropriate standard of review for a district court's order entered in a receivership action, like the order at issue on this appeal, is "abuse of discretion." *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 87 (2nd Cir. 2002); *SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2nd Cir. 1997); *SEC v. Wang*, 944 F.2d 80, 85 (2nd Cir. 1991). A district court abuses its discretion when its ruling is based on an incorrect legal standard or a clearly erroneous finding of fact. *Warner-Lambert Co. v. Northside Dev. Corp.*, 86 F.3d 3, 6 (2nd Cir. 1996).

In reviewing district court orders for abuse of discretion in receivership proceedings, appellate courts afford broad deference to the district courts' supervisory roles and generally uphold reasonable procedures that serve the purpose of orderly and efficient administration of the receivership for the benefit of creditors. *SEC v. Hardy*, 803 F.2d 1034, 1037-1038(9th Cir. 1986). District courts have broad authority to craft remedies for violations of federal securities laws. *Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 81 (2nd Cir. 2006); *SEC v. Forex Asset Mgmt.*, 242 F.3d 325, 332 (5th Cir. 2001).

"[W]ithin that broad authority lies the power to approve a plan of distribution proposed by a federal receiver." *SEC v. Byers*, 637 F.Supp.2d 166, 174 (S.D.N.Y. 2009) (approving receiver's distribution plan in Ponzi scheme case), citing *Credit Bancorp, supra*, 290 F.3d at 82-83. District courts have the authority to approve any plan provided it is "fair and reasonable." *SEC v. Wang*, 944 F.2d 80, 88 (2nd Cir. 1996); *Byers, supra*, 637 F.Supp.2d at 174. "An equitable plan is not necessarily a plan that everyone will like." *Id*. at 168. "Indeed, when funds are limited, hard choices must be made." *In re The Reserve Fund Securities and Derivative Litigation*, 673 F.Supp.2d 182, 195 (S.D.N.Y. 2009), quoting *WorldCom, supra*, 467 F.3d at 82.

KCERA acknowledges, and agrees, that the District Court had broad discretion in deciding whether to approve the Receiver's distribution plan. *See*, Appellee and Cross-Appellant KCERA's Principal & Response Brief (the "KCERA Brief"), p. 13 ("In evaluating and adopting a distribution plan, the district court was acting 'pursuant to its inherent equitable powers' and thus had very 'broad discretionary power' to fashion any remedy the court reasonably believed was best suited to the needs of the case").

IV

SUMMARY OF ARGUMENT

This case arises out of a unitary Ponzi scheme made up of related entities (the "Westridge Entities") that collapsed in 2009 (for purposes of this brief, the Westridge Entities are comprised of WG Trading Company LP and WG Trading Investors, LP). Appeals have been taken from an order (the "Distribution Order") entered by the District Court (Daniels, J.) on March 21, 2011, which returned almost 85% of the net principal investments of victims of the Ponzi scheme. A1460-1463.[1] The Receiver is the Court-appointed receiver for the Westridge Entities.

The Receiver proposed a plan to the District Court that provided for an initial distribution of $792,538,397 to the current investor victims in the Westridge Entities. The Receiver's plan treated all of the investors equally since they were all victims of the same unified Ponzi scheme and provided that they should receive the same return on their net investments on a *pro rata* basis. The District Court approved the Receiver's plan and authorized the Receiver to make the distribution to the current investors pursuant to the

[1] References herein to the appellate appendix will be preceded by the letter "A" followed by the appropriate page numbers.

Distribution Order.

Two appeals from the Distribution Order are currently pending before this Court. The first is the underlying appeal filed by certain WGTC limited partners (the "WGTC Appellants"). That appeal has been fully briefed by the parties. The second appeal was filed by KCERA as a cross-appeal and is addressed herein. Although KCERA supports the Receiver's position with respect to the WGTC Appellants' appeal (i.e., the District Court properly exercised its discretion when it approved the Receiver's proposed *pro rata* distribution of assets without adjusting for a "prudence premium" in favor of the WGTC Appellants), it contends the District Court erred by not applying an inflation, or "Constant Dollar," adjustment to the distribution plan.[2] KCERA Brief, pp. 14-24.

KCERA's cross-appeal should be rejected and the Distribution Order should be affirmed for two reasons. First, the District Court did not abuse its discretion when it decided against KCERA's proposed inflation adjustment.

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[2] A similar claim was made in a proposal submitted by Qwest Asset Management Company ("Qwest"). The Qwest proposal was filed on October 22, 2010, as SEC Action Docket No. 361 and CFTC Action Docket No. 394. Qwest also filed an appeal from the Distribution Order but subsequently dismissed its appeal.

As noted above, in order to establish that the District Court abused its discretion, KCERA must show that the Distribution Order was based on a clearly erroneous finding of fact or an incorrect legal standard. With respect to factual findings, the District Court correctly determined that KCERA's inflation adjustment would not be fair to the investors. For example, as a result of KCERA's proposed adjustment, some of the investors (including KCERA) would receive millions of dollars over and above their net investments (i.e., the investor's total contributions, minus total withdrawals, unadjusted for inflation or fictitious earnings) before other investors recovered their net investments. An inflation adjustment could also seriously jeopardize the Receiver's efforts to recover, or "claw back," fictitious earnings that were paid to former investors in the Westridge Entities, further putting at risk the same current investors who would suffer most at the hands of KCERA's proposed inflation adjustment. The District Court properly weighed these considerations and determined that a distribution without an inflation adjustment was fair and reasonable. Its determination was not at all erroneous, let alone "clearly erroneous."

KCERA has also failed to show that the Distribution Order was based on an incorrect legal standard. To the contrary, established legal precedent provides that the *pro rata* distribution plan set forth in the Distribution Order is the most favored in receivership cases like this one, where investor funds have been commingled and the victims are similarly situated with respect to the perpetrators. KCERA has not cited a single case standing for the proposition that its inflation adjustment is the correct legal standard to be applied to distributions in receivership cases. The cases that KCERA does cite are inapposite and fall far short of establishing any such standard. Indeed, the District Court would have abused its discretion if it had applied KCERA's inflation adjustment because it would have been based on an incorrect legal standard.

Unable to point to any clearly erroneous factual finding or application of an incorrect legal standard, KCERA is reduced to an argument that the District Court made the wrong choice when it approved a distribution alternative that did not adjust for inflation. KCERA Brief, pp. 25-30. But this argument misapprehends the abuse-of-discretion standard of review. The issue is not whether the District Court made the right choice (and it did for all of the reasons stated below). Appellate courts do not second guess discretionary calls made by district courts. Rather, the issue is whether the court abused its discretion in arriving at the choice it did make. Courts do not abuse their discretion when they choose among competing alternatives - - "right" or "wrong" - - so long as the choice is not based on clearly erroneous facts or incorrect legal standards. In short, the District Court had broad authority to approve *any* distribution plan, provided it was fair and reasonable, even if it was not the plan KCERA preferred.

The second reason why KCERA's cross-appeal should be rejected is because it is moot. KCERA did not seek a stay of the Distribution Order. In the absence of a stay, the Receiver disbursed the funds in compliance with the Distribution Order on April 21, 2011. An inflation adjustment to the Distribution Order would require the Receiver to retrieve the distributed funds from the investors, and from their beneficiaries if the funds were further distributed (the investors are mostly university endowments and public and private pension plans), so that the adjustment could be made to all of the current investors' accounts, and then to redistribute the funds. Trying to recover hundreds of millions of dollars that have already been disbursed would upset the legitimate plans and expectations of the investors (as well as their beneficiaries) engendered by the distribution and would impose an enormous burden and expense on the receivership estate. Even if the cross-appeal had merit (and it does not), the doctrine of mootness militates against such an inequitable result and should be applied here.

V

THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION

For the reasons described below, the Distribution Order is not based on clearly erroneous factual findings or incorrect legal standards. In choosing between alternative proposals, the District Court properly exercised its broad authority and did not abuse its discretion. The Distribution Order should therefore be affirmed.

A. *The Distribution Order Is Not Based On Clearly Erroneous Factual Findings.*

After considering extensive briefing submitted by the investors, the SEC, the CFTC and the Receiver, and after an extended hearing where the parties were given ample opportunity to express their views, the District Court concluded that KCERA's inflation adjustment (and the WGTC Appellants' "prudence premium" adjustment) would not make for a fairer distribution:

> I believe that the issues that we've discussed with regard to both the constant dollar adjustment and the prudence premium issues, those adjustments do not make a fairer distribution for

either the most victims or a large number of victims.

SPA 136:14-18.

The District Court noted that the Receiver's plan was supported by most of the investors and treated the investors fairly:

> I believe that an approximate 85 percent return on principal invested is a significant return, given the nature of this activity and the criminal conduct. What is also important to me is that, although no plan is a perfect plan, it is a plan that most investors believe equitably, across the board, treats each of them in a manner that gives them a significant similar return on their contributions. This distribution most closely mirrors what would be an equal and equitable distribution of the principal contributions of each of the investors. I believe that it is appropriate to, as quickly as possible, begin these distributions based on the calculations that have been done.

SPA 137:6-17.

The District Court's conclusions are well-supported by the facts. The Receiver noted that there were only two proponents of the inflation adjustment, KCERA and Qwest, and that their combined net investment claims were less than 4% of the total net investment claims.[3] SPA 21:11-22:3. If a distribution plan with an inflation adjustment was truly more equitable than the plan proposed by the Receiver, it surely would have garnered more support from the parties affected by the plan.

The other investors undoubtedly refused to support KCERA's inflation adjustment because it would lead to inequitable results. Adjusting for inflation means that long-term investors (most notably, Qwest and KCERA) would receive millions of dollars *more* than their net investments at the expense of other investors, who would receive millions of dollars *less* and therefore be further behind in trying to recover their net investments. For example, as one of the investors pointed out at the hearing on the Receiver's motion to approve the distribution, Qwest contributed $766 million and received back $749 million for a shortfall of $17 million. Under the Receiver's proposed distribution, Qwest would recover $6.4 million. That sum, when added to the $749 million previously returned to Qwest, would bring it to almost 99% of its total contributions. However, with an

[3] Qwest dismissed its appeal from the Distribution Order. Thus, the only proponent of an inflation adjustment is KCERA and it holds an even smaller fraction of the claims.

inflation adjustment, Qwest would receive $38 million, which would be $21 million *more* than its net investment. SPA 109:9-110:1. Similarly, with an inflation adjustment, KCERA would receive $5 million *more* than its net investment. SPA 110:2-11. These returns would have to come out of distributions to other investors and would lead to grossly inequitable results because all investors would not be treated equally.

KCERA's claim that some investors would do better with an inflation adjustment (KCERA Brief, p. 29) also means that other investors would do worse because distribution of a fixed sum of money to multiple parties is a zero sum game. Since the investors who would do worse were also victims of the same Ponzi scheme, the District Court concluded it would not be fair to take money from them so that other investors like KCERA and Qwest could receive millions of dollars over and above their net investments. Again, the basic fairness of the District Court's conclusion is underscored by the fact that none of the other investors, including those who would have done *better* with an inflation adjustment (with the exception of Qwest), joined in KCERA's request.

The long-term consequences of adopting an inflation adjustment could also be significant. If current investors were entitled to adjust their accounts for inflation, the fully redeemed investors who are the subject of the Receiver's clawback actions could make the same argument, i.e., their accounts should also be adjusted for inflation. SPA 23:23-24:3. The Receiver estimated that such an adjustment would reduce the Receiver's clawback claims by approximately 62%. SPA 24:6-17. Total clawback claims are estimated to be $142,874,806. SPA 25:5-9. Reducing those claims by 62% would decrease the potential recovery by $88,582,379. The parties who would be most at risk by such a decrease would be the same parties who would suffer most by an inflation adjustment, i.e., the same investors whose distributions would be reduced so that other investors could recover more than their net investments. SPA 25:13-16.

Finally, KCERA’s claim that it would not “be at all burdensome” to apply an inflation adjustment (KCERA’s opening brief, p. 30) myopically focuses on the math that would be required to adjust the accounts while completely ignoring the practical problems that would be encountered in actually implementing the adjustment. The funds have already been distributed. The Receiver would therefore have to recover the funds from the investors, calculate the adjustment, and then re-distribute the funds. This would create an enormous and expensive burden on the receivership estate (as described below, this burden justifies a dismissal of KCERA's cross-appeal on grounds of mootness).

B. *The Distribution Order Is Consistent With Established Legal Standards.*

The Distribution Order is consistent with existing case law. Courts that have considered the issue have declined compensation for the time value of money in Ponzi scheme and securities fraud receivership cases. *See,* for example, *SEC v. Capital Consultants, LLC,* 2002 U. S. Dist. LEXIS 27399 at *5-8 (D. Or. 2002) (court approval of receiver's proposed distribution plan without adjustment to older and larger accounts for time value of money); *CFTC v. Lake Shore Asset Mgmt., Ltd.*, 2010 WL 960362 at *3 (*supra*) (referring to order disallowing claims in excess of investment); *Higley v. Kidder, Peabody & Co., Inc.*, 920 P.2d 884, 892 (Colo. 1996).

Significantly, KCERA fails to cite a single case endorsing an inflation adjustment to a *pro rata* distribution in a Ponzi-scheme receivership case. KCERA attempts to explain this dearth of authority on the grounds that Ponzi schemes "usually collapse quickly" and do not involve distributions of substantial sums of money. KCERA Brief, pp. 25-26. But this claim is totally unsubstantiated and highly questionable. Other receivership cases have involved Ponzi schemes that lasted for a long period of time or involved distributions of hundreds of millions of dollars. *See, Hedged-Investments Associates, Inc. v. Sender,* 84 F.3d 1286 (10th Cir. 1996) (Ponzi scheme started in the early 1970s collapsed in 1990); *In re Slatkin,* 525 F.3d 805 (9th Cir. 2008) (Ponzi scheme operated from 1986 to 2001); *CFTC v. Lake Shore Asset Mgmt., Ltd.*, 2010 WL 960362 (N.D. Ill. 2010) (initial distribution in excess of $100 million, or 40% of the net investor claims). If the equities of inflation adjustments were as compelling as KCERA claims, cases endorsing such adjustments surely could have been cited.

The cases that KCERA does cite in its brief are inapposite because they involve awards of pre-judgment interest. *See*, for example, KCERA Brief, p. 28, fn. 10. Unlike a damages award, it is not the case here that pre-judgment interest should be awarded to fully compensate a plaintiff for damages caused by a defendant. The investors whose distributions would be reduced by an inflation adjustment did not cause the harm to KCERA and should not have to compensate KCERA regardless of how it labels its damages, whether "time value of money," "Constant Dollar," "pre-judgment interest" or some other form of consequential damages. The District Court properly refused to make innocent investors compensate KCERA for such damages in the form of an inflation adjustment to the Distribution Order.

The only other "authority" cited by KCERA in support of its inflation adjustment is also inapposite. KCERA contends the SEC repeatedly urged an inflation adjustment in the *Madoff* matter and that the SEC's position supports application of an inflation adjustment here. KCERA Brief, pp. 25-26. But the SEC's argument in another matter does not constitute an established legal standard. Moreover, KCERA's contention is utterly undermined by the fact that the SEC and CFTC actually *endorsed* the Receiver's proposed distribution *without* an inflation adjustment. A 1127-1128 (Joint Notice of Recommendation For a Distribution Plan).

KCERA's reliance on *SIPC v. Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010) is also misplaced. The issue in *Madoff* was how to define a claimant's "net equity" under the Securities Investor Protection Act (SIPA) for distribution purposes. The bankruptcy trustee defined net equity as the amount of cash deposited by the customer into his customer account less any amounts already withdrawn by him (the "net investment method"). Objecting claimants defined net equity as the amounts reflected on customers' statements as of a certain date (the "last statement method"). Ultimately, upon a thorough and comprehensive analysis of the plain meaning and legislative history of the SIPA statutes, the court endorsed the trustee's method. *Id.* at 134-143.[4]

The SEC's position in *Madoff* is inapposite for the simple, and dispositive, reason that this is not a SIPA liquidation proceeding - - there is no need to use an inflation adjustment to fulfill the purpose of SIPA because SIPA is not at issue. Under SIPA, a fund has been established to protect the customers of brokers or dealers subject to the SIPA from loss in case of financial failure of the member (the fund is authorized by 15 U.S.C. section 78ddd(a), and assessments against members are authorized by 15 U.S.C. Sections 78ddd(c) and (d)). The issue in *Madoff* was how the investors' accounts should be valued for compensation out of the SIPC fund. Here, it is not a third-party fund that is being asked to compensate investors for the time value of their investments. An inflation adjustment in favor of some investors *comes out of distributions to other investors*, who were not asked to assume that risk when they invested and were certainly not compensated for the risk.

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[4] This Court affirmed, without reaching the issue whether an inflation adjustment should be applied to the trustee's distribution. *In Re Bernard L. Madoff Inv. Sec. LLC,* 654 F.3d 229, 235, fn. 6 (2nd Cir. 2011).

C. *Making A Choice Among Alternatives Is Not An Abuse of Discretion.*

KCERA's proposed inflation adjustment is inequitable and contrary to legal standards for the reasons stated above. But even if KCERA's proposal were equitable and sanctioned by established legal precedent, it does not follow that the District Court abused its discretion by selecting a proposal that was also equitable and sanctioned by established legal precedent. By definition, an exercise of discretion involves choice and is not abused simply because one alternative is chosen over another.

KCERA does not contend that the Receiver's distribution plan was unfair or unreasonable. Indeed, in its response to the WGTC Appellants' appeal, KCERA argued that the Receiver's distribution plan is fair and reasonable, and that the District Court properly exercised its discretion when it declined the WGTC Appellants' request for a "prudence premium" adjustment. The plan did not suddenly become unfair or unreasonable when the District Court also declined KCERA's request for an inflation adjustment.

KCERA also concedes that *pro rata* distributions are "the most favored in receivership cases" and are particularly favored in Ponzi scheme cases where investor funds are commingled and victims are similarly situated with respect to the perpetrators. KCERA Brief, p. 14 (citing *Byers*, *supra*, 637 F.Supp.2d at 176, and *Credit Bancorp*, *supra*, 290 F.3d at 89). And, as KCERA aptly observed in addressing the WGTC Appellants' claim that the District Court abused its discretion by not approving the "prudence premium" adjustment, "[t]here was no legal error, merely a discretionary choice." KCERA Brief, p. 22. Similarly, the District Court made a discretionary choice and committed no legal error when it rejected KCERA's proposed inflation adjustment.

The distribution plan proposed by the Receiver was based on a thorough investigation of the facts and detailed forensic accounting investigation, it was supported by well-established legal precedent, and it was consistent with the equitable maxim that equality is equity. The District Court did not abuse its discretion by adopting a method of distribution that was thoroughly investigated and sanctioned by precedent, even if it was not the plan that KCERA preferred. The District Court simply made a choice, which is the essence of an exercise of discretion, and committed no legal error.

Accordingly, for all of the reasons stated above, the District Court properly exercised its discretion in deciding that the current investors' claims should not be adjusted for inflation.

VI

THE CROSS-APPEAL SHOULD BE DISMISSED AS MOOT

In its brief in response to the WGTC Appellants' appeal, the Receiver argued that the appeal should be dismissed because it is moot. The same argument applies with equal vigor to KCERA's appeal.

A case is moot when it is impossible for the court to redress the injury, or, in the context of injunctions, where the act sought to be restrained has already occurred and the appellate court cannot undo what has already been done. *See, e.g.*, *University of Texas v. Camenisch*, 451 U.S. 390, 398, 68 L.Ed.2d 175, 101 S.Ct. 1830 (1981) ("The question whether a preliminary injunction should have been issued here is moot, because the terms of the injunction . . . have been fully and irrevocably carried out."); *Alexander v. Yale University*, 631 F.2d 178, 183 (2d Cir. 1980) ("A party's case or controversy becomes moot … when it becomes impossible for the courts, through the exercise of their remedial powers, to do anything to redress the injury."). The doctrine of mootness facilitates finality, which is essential to the fashioning of effective remedies. *Official Committee of*

Unsecured Creditors of LTV Aerospace & Def. Co. v. Official Committee of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.), 988 F.2d 322, 325-326 (2d Cir. 1993) ("[a]s a practical matter, completed acts in accordance with an unstayed order of the bankruptcy court must not thereafter be routinely vulnerable to nullification if a plan of reorganization is to succeed").

The ability to achieve finality is essential in securities-fraud receiverships and the doctrine of mootness has been applied in that context. *See*, *SEC v. Wozniak*, 33 F.3d 13, 15 (7th Cir. 1994) (noting in dicta that the doctrine would govern in deciding whether to undo a distribution by a securities-fraud receiver), overruled on other grounds by *SEC v. Enter. Trust Co.*, 559 F.3d 649 (7th Cir. 2009); *SEC v. Capital Consultants, LLC*, 397 F.3d 733, 745-46 (9th Cir. 2005) (applying the doctrine when considering whether to unwind a receiver's distribution plan in a securities-fraud case). *See*, also, *United States v. Segal*, 432 F.3d 767, 773-774 (7th Cir. 2005) (invoking the doctrine when evaluating whether to undo a business transaction resulting from a RICO forfeiture).

In *SEC v. Wealth Mgmt., LLC*, 628 F.3d 323 (7th Cir. 2010) the court noted that the doctrine of equitable mootness derives from the principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties (citing *In re Envirodyne Indus., Inc.*, 29 F.3d 301, 304 (7th Cir. 1994)), and that there are two key factors in resolving the issue of equitable mootness: (1) the legitimate expectations engendered by a plan of distribution; and (2) the difficulty of reversing consummated transactions. These factors weigh "'the virtues of finality, the passage of time, whether the plan has been implemented and whether it has been substantially consummated, and whether there has been a comprehensive change in circumstances.'" *Id.* at 331-332 (quoting from *United States v. Segal*, *supra*, 432 F.3d at 774). The court held that the doctrine of equitable mootness applied to the receivership distribution order at issue in that case, but did not take the analysis any further because if affirmed the distribution order on the merits. *Id.* at 332.

As noted above, KCERA does not address the practical difficulties its requested relief would entail. If the Distribution Order is vacated, $792,538,397 would have to be returned to the Receivership estate by many investors (and their beneficiaries if the funds were further disbursed to them), which would upset the legitimate expectations of the investors and their beneficiaries, and create enormous difficulties in trying to reverse the distributions. In the meantime, KCERA has had the best of both worlds. It has had the benefit of millions of dollars that were distributed to KCERA pursuant to the Distribution Order while it prosecutes its appeal.

The doctrine of equitable mootness should therefore be applied with respect to KCERA's cross-appeal. Unstayed distribution orders should not be routinely vulnerable to nullification if the administration of receivership estates is to succeed. Vacating the Distribution Order and requiring the Westridge investors, and their beneficiaries, to return the funds that were distributed pursuant to the Distribution Order would upset the two key factors that are addressed by the doctrine of mootness. It would unsettle the legitimate expectations of the investors and their beneficiaries engendered by the Distribution Order, and it would create countless unforeseen difficulties in trying to reverse the distributions. *See, SEC v. Credit Bancorp,* 194 F.R.D. 457, 464 (S.D.N.Y. 2000) ("As counsel is no doubt aware, once assets have been distributed, their retrieval may not be possible").

The Receiver respectfully submits that the Distribution Order should be affirmed on the merits for all of the reasons stated above. But even if this Court were not inclined to do so, it should determine that the issue is now moot and dismiss the appeal. It would create an enormous burden and expense to the receivership estate if the Receiver is required to recover funds that investors and their beneficiaries are either unwilling or unable to return, and it would upset the legitimate expectations of the investors and their beneficiaries.

VII

CONCLUSION

The Distribution Order should be affirmed because the District Court properly exercised its discretion in determining that the *pro rata* plan of distribution proposed by the Receiver was fair and reasonable. Alternatively, the appeal should be dismissed as moot because Appellants did not obtain a stay and the Distribution Order has been fully executed.

Dated: December 12, 2011
Los Angeles, California

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS AND TYPE STYLE REQUIREMENTS

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 5,763 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using the 2007 version of Microsoft Word in 14-point Times New Roman font.

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Dated: December 12, 2011

STATE OF NEW YORK)
) ss.: **AFFIDAVIT OF**
COUNTY OF NEW YORK) **CM/ECF SERVICE**

I, Kersuze Morancy, being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age.

On December 12, 2011

deponent served the within: **Brief of Receiver-Appellee In Answer to Principal Brief of Cross-Appellant KCERA**

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