UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	CIVIL ACTION FILE NO. 1:13-CV-01817-WSD
v.	)	
DETROIT MEMORIAL PARTNERS, LLC and MARK MORROW,	)	
Defendants.	)	

RECEIVER'S RESPONSE TO OBJECTION OF CLAIMANT LEONARD J. WALTER TO RECEIVER'S PROPOSED PLAN OF DISTRIBUTION

I. INTRODUCTION

DMP debt holder claimant Leonard Walter has objected to the Receiver's proposed plan of distribution (the "Proposed Plan"). The Receiver recommended that Mr. Walter share in the distribution of receivership funds on equal footing with the 177 other debt holders who are similarly situated to Mr. Walter, save for the fact that Mr. Walter beat the others to the courthouse and obtained a judgment and charging order against DMP during the pendency of this SEC enforcement action but before the stay of litigation was entered by the Court. The Receiver understands Mr. Walter's desire to obtain a full recovery of the funds he lost (plus

approximately $90,000 of interest) in the Ponzi scheme that is the subject of this lawsuit. However, the Receiver does not believe Mr. Walter's circumstances justify, or that applicable case law requires, that Mr. Walter be permitted to collect the full amount of his investment *plus interest* while the other identically-situated claimants receive only a portion of their investments back. For the reasons more specifically explained herein, Mr. Walter's objection should be overruled.

II. FACTUAL BACKGROUND

The SEC filed its initial action against Summit Wealth Management, Inc. ("Summit") and three Summit-affiliated funds on September 18, 2012. [*See SEC v. Alleca et al.*, Case No. 1:12-cv-03261-WSD (the "Summit SEC Action"), Doc. 1.] The Summit Receiver, Robert Terry, was appointed on September 21, 2012. [Summit SEC Action at Doc. 9.] The order appointing Mr. Terry was modified on November 21, 2012. [*See* Modified Order Appointing Receiver, Summit SEC Action, Doc. 27.] The modified order contained a stay of all litigation against the defendants in the Summit SEC Action. (*Id.* at ¶XVI.) The Summit Receiver posted the modified order on his website on or about January 29, 2013. [*See* www.swmreceivership.com, last visited Oct. 17, 2016.]

Mr. Terry sent claim forms out to Summit claimants on January 23, 2013. [*See* Jan. 23, 2013 Letter and claim form sent in Summit SEC Action, attached

hereto as Exhibit A.] As a Summit account holder, Mr. Walter would have received a Summit claim form. The Summit claim form explains the claim submission process, and also contains a box on page 4 that states, "If you have a claim arising from Detroit Memorial Partners, LLC, please indicate here," next to a checkbox. [Ex. A at 4] The cover letter also directs the claimant to the Summit Receiver's website, www.swmreceivership.com, which contained a posting on January 29, 2013 with a "Q&A" document that stated,

> It appears that most of the claims will arise because of investments by Summit clients in one of four funds:
>
> Summit Investment Fund, LP
> Asset Class Diversification Fund, LP
> Private Credit Opportunities Fund, LLC
> Detroit Memorial Partners, LLC

[*See* "Questions and Answers," attached hereto as Exhibit B.] **As of January 2013 (before Mr. Walter sued DMP), any potential Summit investor claimant – including Mr. Walter – would have been, or at least should have been, aware of a potential securities violation relating to DMP.**

Just over two months later, on April 12, 2013, Mr. Walter filed his lawsuit in the United States District Court for the Eastern District of Michigan, Case No. 2:13-cv-11676-DPH-RSW, against DMP for breach of the DMP notes that Mr. Walter purchased through Summit (the "Michigan Action"). [Doc. 171 at 2.]

A month later, on May 30, 2013, the SEC filed this action against DMP. The Michigan Action was still ongoing at the time. Mr. Walter took advantage of the chaos within DMP, as DMP did not answer the Michigan Action. Mr. Walter obtained a default judgment on June 21, 2013. In the meantime, and luckily for Mr. Walter, DMP and Morrow (through Morrow's former counsel) sought and obtained two months' worth of extensions to file an answer in this SEC action, eventually answering on August 16, 2013. The other DMP members filed their own answer on August 14, 2013, causing confusion as to who controlled DMP and who had the right to represent DMP in this case, which quickly led the SEC to file a motion on September 24, 2013 to appoint a Receiver for DMP.

Mr. Walter cited the confusion in this SEC case in his August 29, 2013 Memorandum of Law in Support of His Motion for Charging Order filed in the Michigan Action, which is attached hereto as Exhibit C:

> On May 30, 2013, the SEC filed a lawsuit against DMP along with Mark Morrow – the individual who the SEC alleges is DMP's managing member – in the United States District Court for the Northern District of Georgia. In its complaint, the SEC alleges that DMP owns a 49% membership interest in MMG.
>
> Attorneys from two separate law firms filed appearances on behalf of DMP, each firm filing a different answer on behalf of MMG. Both admit that DMP owns a 49% membership interest in MMG.

[Ex. B at 2 (internal citations omitted).] The Memorandum also contained a footnote stating, "The first law firm appears to be taking instruction from Morrow, and the second law firm appears to be taking instruction from other individuals who purport to be members of DMP." [Ex. B.]

Given these statements, Mr. Walter not only knew about this SEC action, but Mr. Walter was pursuing a charging order at least in part because of this SEC action. Mr. Walter also knew, or at least should have known upon reading the SEC's Complaint, that there were numerous other DMP debt holders in his exact same position. He nevertheless moved to gain an advantage over those other debt holders by securing a judgment against DMP. The court in the Michigan Action entered an Order Granting Motion for Charging Order on September 11, 2013 (the "Charging Order"). [Doc. 171-2.] The DMP Receiver was appointed two months later on November 22, 2013, and the Order Appointing Receiver stayed all litigation against DMP. [Doc. 51.]

The Charging Order states that "[DMP's] membership interest in Midwest Memorial Group, LLC ['MMG'] shall be subject to a lien and charging order in favor of and for the benefit of Plaintiff for payment of the default judgment entered by the Court on June 21, 2013." At the time the Charging Order was entered, Mr. Walter knew or should have known that Morrow and DMP had effectively

admitted in their Answer that DMP's interest in MMG had been acquired with funds from investors using a fraudulent private placement memorandum. [*See* Doc 15, Answer and Defenses, at ¶ 15 (admitting that DMP only had a 49% equity interest in MMG); *see also id.* at ¶ 36(b) (admitting that private placement memorandum falsely stated that DMP had "equity in real property and cemeteries and other assets available to use to pay principal or interest on the Notes."); ¶ 38 (admitting that the 49% interest was acquired with funds raised using the private placement memorandum).]

Mr. Walter admits that he invested a total of $300,000, but he is only claiming an investment of $200,000 here. That is because DMP, or someone acting on its behalf before the appointment of the Receiver, redeemed $100,000 worth of notes for Mr. Walter. The Receiver has no evidence of why this occurred, but it is undisputed that only a few other debt holders managed to receive redemptions from DMP. The Receiver did not attempt to claw this redemption back after determining the cost of pursuing it would not have been the most efficient use of the Receiver's resources. However, it is important to note that Mr. Walter is asking the Court to help him recover his initial investment of **$300,000, plus over $90,000 in interest payments**. This would result in a windfall to Mr. Walter that would come directly from other claimants' monies.

While there is no indication that Mr. Walter acted in bad faith in obtaining his judgment and charging order, it does appear that Mr. Walter took advantage of a gap between the stay of litigation entered in the Summit receivership and the stay of litigation in the DMP receivership.

The Receiver's position is that Mr. Walter's judgment cannot, and should not, be afforded a priority over the other debt holders who have submitted claims to the Receiver in this case. Mr. Walter's situation is virtually identical to the other debt holders – he was sold promissory notes based on a number of false statements, and DMP, after paying interest payments for a period of time, defaulted on the notes. Mr. Walter does not dispute this. Further, the property on which he claims a lien – DMP's 49% interest in MMG, and the proceeds derived from it – **was indisputably obtained using funds from defrauded investors**. Based on these facts, there is no legal or equitable justification for allowing Mr. Walter to obtain a "larger piece of the pie" than the other claimants.

III. ARGUMENT AND CITATION TO AUTHORITY

A. DMP Has No Title to the Assets Upon Which Mr. Walter Has Obtained a Lien.

This Court has held that one cannot obtain title in property when the property was acquired through a fraud. *See First Nat. Bank of Cartersville v. Hill*, 412 F.Supp. 422 (N.D. Ga. 1976). "It is a general rule of common law that no title

is acquired by an embezzler, but that such title remains in the victim, who is the beneficial owner of a constructive trust which is imposed on such monies or on property purchased with such money." *Id.* *See also Fid. & Deposit Co. of Md. v. Stordahl*, 353 Mich. 354, 358–59 (1958) (where money held in trust is misapplied and traced into an unauthorized investment, trust becomes equitable owner of such property; beneficiaries have a legal, not equitable, interest in the trust).

In *Hill*, it was undisputed that Hill embezzled $4,700,000 from a bank. The federal government had a judgment and tax lien against Hill and the federal government sought priority for its tax lien over a $5,800,000 judgment that bank had against Hill due to the embezzlement.

The Court held that a federal tax lien can attach *only* to a property interest of a taxpayer existing under state law, and the federal tax liens at issue could not attach to any of the subject property because the property was purchased with embezzlement proceeds. Specifically, the Court held that Hill "obtained no title to or property rights in these funds and that he obtained no rights to any property which was purchased with these embezzled funds." *Id.* Instead, the Court held that Hill held the property as a constructive trustee for the victim Bank. *Id.*

Here, Mr. Walter's argument is that he has an enforceable lien against DMP property is flawed. While Mr. Walter could have an enforceable lien on

legitimately obtained DMP Property, DMP has no such property. All of DMP's assets were acquired by funds traceable to fraud victims.[1] DMP has no legitimately obtained funds or assets that were obtained outside of fraud, and thus Mr. Walter's lien does not attach to the funds that the DMP Receiver seeks to distribute.

B. Mr. Walter Does Not Fit the Exception for Third Parties Who Obtained the Liens in Separate Legitimate Transactions.

The cases Mr. Walter cites for his position that secured parties have priority over unsecured claimants in an SEC civil receivership context principally involve parties who took a security interest in a transactional context. *See, e.g. S.E.C. v. Credit Bancorp, Ltd.*, 279 F. Supp. 2d 247 (2003) (involving security interest by non-claimant Deutsche Bank taken as collateral for certain debts); *S.E.C. v. Management Solutions, Inc.*, 2013 WL 594738 (D. Utah Feb. 15, 2013) (involving non-claimant Fannie Mae's security interest in mortgage prepayment premiums).

Mr. Walter's security interest is a completely different situation, because he did not provide any consideration in a transactional context for his security interest.

[1] Mr. Walter cites *Lanklenau v. Coggeshall & Hicks*, 350 F. 2d 61, 67 (2nd Cir. 1965) for the proposition that the receiver takes custody of property subject to any rights previously acquired by the attachment. However, the court noted in that case that the secured parties rights "may ultimately be subordinated to a better claim," as where the attached assets are traceable to monies obtained by fraud, as they are here. *Id.*

He was just first to the courthouse among the other DMP claimants, and he benefitted from the delay in this case that led to two Answers being filed and the Receiver eventually being appointed. If Mr. Walter wins his objection, he would do so without any benefit of a bargain separate from the deal he made in signing the DMP subscription agreements under false pretenses – the exact same circumstances as virtually every other debt holder in this case.

Moreover, he would receive a priority position in the Plan of Distribution that will simply give him a bigger share of a pool of assets that were procured by fraud. If the equitable powers of the Court overseeing an S.E.C. receivership have meaning, they should mean that similarly situated victims of the fraud should recover equally. The policy for this position is self-evident, as the opposite rule would encourage claimants to try and file suit as fast as possible so that they can procure a judgment lien by default before any stay of litigation is entered. In such a case, a few claimants could rush to beat the entry of a receivership order and obtain liens on the entire receivership fund, leaving the Receiver with nothing to compensate the other claimants.

Not only is this not the equitable result, but it is not required by the applicable caselaw. Federal courts have held that where a creditor in an SEC Receivership has a security interest in property that was acquired by the fraud at

issue, such a lien may be disregarded. In *S.E.C. v. Quan*, the United States District Court for the District of Minnesota denied a secured creditor's[2] request to exclude secured assets from the receivership estate. *See* No. 11–CV–0723, 2013 WL 1703499, at *4 (D.Minn. Apr. 19, 2013). The court concluded that the secured assets at issue could be subject to disgorgement because those assets were allegedly purchased with monies fraudulently obtained from investors. *Id.* The court held that it had "broad authority to approve[ ] a distribution plan that is governed by equitable principles rather than ... legal rules governing priority." *Id.* at *5.

Here, as in *Quan*, it is undisputed that the monies solicited from the individual debt holders by way of the fraudulent private placement memorandum were used to buy DMP's 49% interest in MMG, which in turn is the asset over which Walter claims a lien. Mr. Walter cites no authority that would permit him to use his charging order to recover his full investment, plus interest, to the detriment of all the other similarly-situated debt holder claimants.

[2] While the *Quan* opinion does not squarely identify the creditor, DZ Bank, as a secured creditor, the briefs and an earlier opinion in the case indicate that DZ Bank had both secured and unsecured claims. See *Quan*, No. 11–CV–723, 2012 WL 1516977, at *1 (Apr. 30, 2012); *see also* DZ Bank's Resp. to Mot. to Intervene at 3–4, *Quan*, Doc. 242.

The Receiver's Plan of Distribution cites the case *S.E.C. v. Amerindo Inv. Advisors Inc.*, No. 05 CIV. 5231 RJS, 2014 WL 2112032, at *15-17 (S.D.N.Y. May 6, 2014) in which the United States District Court for the Southern District of New York held that a group of investors with a judgment against certain defendants were not entitled to priority over other claimants. The court concluded that the judgment holders "fundamentally misunder[stood] the nature of the receivership and the distribution." The court held that the ultimate decision of how much to distribute in an SEC receivership and to whom is the court's alone, and does not belong to the receiver. *Id.* The court further stated that the court's role in determining how much to distribute and to whom is one of equity.

Mr. Walter attempts to distinguish *Amerindo* by the fact that he claims to be a lien creditor by virtue of the charging order, and he contends that the *Amerindo* claimants were merely judgment creditors. However, as an initial matter, the judgment creditors in *Amerindo* spoke of having a "judgment lien" on the assets of the company, yet that was not found to be a basis for priority treatment for their claims. *See Amerindo*, Doc. 395 at 1, Receiver's Omnibus Reply to Opp. to Receiver's Am. Mot. for Order (a) Fixing Investor Claims and (b) Authorizing Interim Distribution, attached hereto as Exhibit D ("As a result of their subsequent execution of the Judgments, the Mayers further claim that they hold a ***senior,***

perfected judgment lien against all the funds under the Receiver's control, which lien entitles them to priority treatment over all other investor claimants."). In any event, there is nothing in any of the authorities cited by Mr. Walter that make a distinction between lien creditors and judgment creditors in the Receivership context and hold that the former receive a priority while the latter do not.

Mr. Walter cites the U.S. Supreme Court case *Marshall v. New York*, 254 U.S. 380 (1920), in which the issue was "whether the state of New York has priority in payment out of the general assets of the debtor over other creditors whose claims are not secured by act of the parties nor accorded a preference, by reason of their nature, by the state Legislature or otherwise." *Id.* at 382. The Court looked to whether state law granted the state a prerogative right, by virtue of being a sovereign entity, to collect annual franchise taxes from receivership property. The Court resolved the issue in favor of the state. The issue before this Court is different than the issue in *Marshall* in two critical respects: (1) here we have one creditor who beat the others to the courthouse and claiming more in receivership funds than others similarly situated, and (2) all of DMP's assets were obtained by fraud and thus are not subject to lien in the first place, as discussed *infra* in Section IIIA. Thus, *Marshall* is not on point here.

Mr. Walter also cites *Management Solutions*, in which Fannie Mae sought to exclude from the Receivership certain mortgage prepayment premiums, which were a previously-bargained-for security interest. Fannie Mae was not a victim of the fraud at issue, it was simply objecting to being divested of its security interest as a third party, and in any event the court held that the issue was not ripe for adjudication, and might not ever be. Thus, there was no holding relating to Fannie Mae that provides any guidance here.

Mr. Walter also cites the case *SEC v. Credit Bancorp, Ltd.*, 279 F. Supp. 2d 247 (S.D.N.Y.), in which the question presented to the district court was whether a third party, Deutsche Bank, had to disgorge to the SEC receiver certain securities held in an account as collateral for a loan made by the bank. The court ruled that it would not disregard Deutsche Bank's security interest as an equitable matter, which is logical because the court needed first to decide whether there was a security interest at all, and because Deutsche Bank had obtained the securities as collateral in a legitimate separate transaction.

Interestingly, the district court in *Credit Bancorp* found in favor of the Receiver because under Deutsche Bank was found to have "ignore[d] circumstances strongly suggesting the likelihood that [a claim to the assets]

exist[ed]," *see* 386 F.3d at 454, which is the Receiver's reason for opposing Mr. Walter's objection in this case.

IV. CONCLUSION

In sum, Mr. Walter's objection should be overruled because (1) he was aware of the DMP fraud at the time he received his charging order; (2) DMP had no legitimately acquired property over which a lien could be imposed, and (3) none of the authorities cited by Mr. Walter would allow him to take a larger share of this illegally-obtained asset than the other similarly-situated claimants.

The Receiver notes that, in order to provide finality and resolve this dispute, the Receiver is willing to settle with Mr. Walter (with this Court's approval) by paying Mr. Walter the attorneys' fees that he incurred in obtaining his judgment and charging order. The Receiver would additionally pay Mr. Walter the distribution recommended in the Receiver's Plan of Distribution. This would put Mr. Walter on equal footing with the other debt holders. The Receiver offered this to Mr. Walter prior to the hearing on this motion, but Mr. Walter rejected the offer. The Receiver believes this was a fair offer to Mr. Walter, and this offer remains open to Mr. Walter if he wishes to accept it, subject to this Court's approval.

Respectfully submitted this 18th day of October, 2016.

/s/ Jason S. Alloy
Jason S. Alloy
Georgia Bar No. 013188
ROBBINS ROSS ALLOY BELINFANTE LITTLEFIELD LLC
999 Peachtree Street, N.E., Suite 1120
Atlanta, Georgia 30309
Telephone: 678-701-9381
Facsimile: 404-601-6733

Appointed Receiver for Defendant Detroit Memorial Partners, LLC

CERTIFICATE OF SERVICE

I hereby certify that the foregoing **RECEIVER'S RESPONSE TO OBJECTION OF CLAIMANT LEONARD J. WALTER TO RECEIVER'S PROPOSED PLAN OF DISTRIBUTION** has been prepared with one of the font and point selections approved by the Court, and that it has been filed electronically with the Clerk of Court using the CM/ECF system, which will send notification of such filing to all attorneys of record. The foregoing was also personally served by email and U.S. Mail on Defendant Mark Morrow at his last known addresses.

Mark Morrow
8643 Twilight Tear Lane
Cincinnati, Ohio 45249
mmorr7887@aol.com

This 18th day of October, 2016.

/s/ Jason S. Alloy
Jason S. Alloy