IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

MICHAEL J. QUILLING, RECEIVER FOR SARDAUKAR HOLDINGS, IBC and BRADLEY C. STARK,	§	
Plaintiff,	§	CIVIL ACTION NO. 3:05-CV-1976-G
v.	§	
JOHN W. STARK, JR. and BARBARA STARK,	§	
Defendants.	§	

PLAINTIFF'S RESPONSE TO DEFENDANTS' MOTION TO DISMISS

TO THE HONORABLE A. JOE FISH, CHIEF UNITED STATES DISTRICT JUDGE:

COMES NOW, Michael J. Quilling, in his capacity as Receiver for Sardaukar Holdings, IBC and Bradley C. Stark ("Receiver") and responds to the Motion to Dismiss filed by John W. Stark, Jr. and Barbara Stark (collectively, the "Defendants") and would respectfully show this Court as follows:

I. INTRODUCTION

In July 2005, the Securities and Exchange Commission initiated a civil action against Bradley C. Stark ("Stark"), Sardaukar Holdings, IBC ("Sardaukar"), and others for operating a *Ponzi* scheme under Stark's control. *See Securities and Exchange Commission v. Megafund Corporation et al.*, Civil Action No. 3:05-CV-1328-L (N.D. Tex.). In particular, investors sent funds to Sardaukar with the understanding that Stark would supervise those funds and apply them towards various investments. Stark, however, systemically diverted large sums of investor money to support

an extravagant lifestyle and to personally benefit himself, his friends, and his family. Among those who benefitted from Stark's scheme were his father, John W. Stark, Jr. ("John Stark"), and his mother, Barbara Stark ("Barbara Stark").

On July 5, 2005, the Court issued an Order appointing Michael J. Quilling as receiver for Stark and Sardaukar. *Complaint* [Dkt. No.1] at ¶ 6. The purpose of the receivership is to preserve and protect the assets of the Receivership Estate for the benefit of creditors and the defrauded investors.

The Receiver initiated this lawsuit to recover assets of the Receivership Estate that were transferred to the Defendants as part of Stark's *Ponzi* scheme. *Complaint* at ¶¶ 8, 9. Specifically, the Receiver seeks to recover in excess of $170,000 of investor funds that Stark diverted to the Defendants between October 2004 and July 2005. *Complaint* at ¶ 9; *Receiver's Preliminary Report* [Case No. 3:05-CV-1328-L, Dkt. No. 52] at ¶ 1.

Defendants seek to have the Receiver's suit dismissed through a motion that is deficient in its form and baseless in its content. First, the Defendants ignored the clear mandate of Local Civil Rules 7.1(d) and 7.1(h) when they filed their Motion to Dismiss without an accompanying brief of law and facts. Second, the Defendants fail to recognize that this Court enjoys statutory nationwide *in personam* jurisdiction over them under 28 U.S.C. § 754 and § 1692. Third, Federal Rule of Civil Procedure 12(b)(6) does not warrant dismissal in this case because the Complaint clearly states a claim for which relief can be granted. Finally, the pleading standard for fraud in Federal Rule of Civil Procedure 9(b) is inapplicable in ancillary cases brought by the Receiver and, alternatively, has been satisfied by the Complaint's particular description of the fraudulent conduct. For these reasons, which are explained more fully below, the Defendant's Motion to Dismiss should be denied.

II. ARGUMENTS AND AUTHORITIES

A. Defendants' Motion to Dismiss is Deficient Under the Local Rules of this Court.

This Court should deny Defendants' motion because the motion itself is patently deficient under the Local Civil Rules of this Court. Local Civil Rules 7.1(d) and 7.1(h) state that a Motion to Dismiss "must be accompanied by a brief that sets forth the moving party's contentions of fact and/or law, and argument and authorities . . . ." Local Civil Rule 7.1(d) (emphasis added); *see also* Local Civil Rule 7.1(h) (listing Motions to Dismiss in the "[b]rief required" category). The Court may properly deny motions filed without such a brief. *See Layfield v. Bill Heard Chevrolet Co.*, 607 F.2d 1097, 1099 (5th Cir. 1979) ("A local rule of the district court requires that all written motions be accompanied by supporting briefs and affidavits. In our opinion, the district court could properly deny [appellant's motion] for failure to comply with the local rule"); *see also Shabazz v. Franklin*, 380 F. Supp. 2d 793, 798 (N.D. Texas 2005) ("[s]uch deficiencies are sufficient of themselves to deny plaintiff's motions"). The Defendants in this case did not submit a supporting brief with their motion as required by the Local Rules. Therefore, the motion was not filed in a "procedurally proper manner" and should be denied as deficient. *See, e.g., Shabazz*, 380 F. Supp. 2d at 798.

B. Federal Statutes Give this Court *In Personam* Jurisdiction Over the Defendants.

Courts in federal equity receivership cases acquire nationwide *in personam* jurisdiction through the interplay of 28 U.S.C. § 754 and § 1692, rather than the traditional minimum contacts analysis. *S.E.C. v. Vision Comm., Inc.*, 74 F.3d 287, 290 (D.C. Cir. 1996); *American Freedom Train Foundation v. Spurney*, 747 F.2d 1069, 1073 (1st Cir. 1984); *Haile v. Henderson Nat'l. Bank*, 657 F.2d 816, 823-24 (6th Cir. 1981); *S.E.C. v. Cook*, Cause No. 3-01-CV-0480-R, 2001 WL 803791, *2-3 (N.D. Tex. July 11, 2001). Federal Rule of Civil Procedure 4 contemplates that a district court may acquire personal jurisdiction through the use of United States statutes providing for service of

process on parties outside that state where the district court is located. FED. R. CIV. P. 4(k)(1)(D); *see also Haile v. Henderson Nat'l. Bank*, 657 F.2d 816, 824 (6th Cir. 1981). In receiverships, 28 U.S.C. § 754 and § 1692 provide for such extraterritorial service of process.

Section 754 extends the territorial jurisdiction of the district court to any territory where property of the receivership estate is present. Specifically, § 754 provides:

> A receiver appointed in any civil action or proceeding involving property, real, personal or mixed, situated in different districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession thereof.
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> * * *
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> Such receiver shall, within ten days after the entry of the his order of appointment, file copies of the complaint and such order of appointment in the district court for each district in which property is located.

Section 1692 provides for service of process in any district where § 754 filings are properly made. Section 1692 provides in pertinent part:

> In proceedings in a district court where a receiver is appointed for property, real, personal or mixed, situated in different districts, process may issue and be executed in any such district, but orders affecting the property shall be entered of record in each such district.

Through the interaction of § 754 and § 1692, the receivership court acquires both *in rem* and *in personam* jurisdictions in all districts where § 754 filings are timely made. *Vision Comm., Inc.*, 74 F.3d at 290; *Haile*, 657 F.2d at 823-24. Courts have recognized that these statutes "facilitate judicial efficiency by permitting courts to manage claims regarding receivership property in a single forum." *Quilling v. Grand Street Trust,* Case No. 3:04-CV-251, 2005 WL 1983879 (W.D.N.C. Aug. 12, 2005); *Terry v. June*, No.. 3:03-CV-52, 2003 WL 22125300, *5 (W.D. Va. Sept. 12, 2003).

Case law further illustrates the extent of *in personam* jurisdiction in receivership cases. For

example, in *Quilling v. Grand Street Trust*, 2005 WL 1983879 (W.D.N.C. Aug. 12, 2005), the Court appointed a Receiver for an individual and several entities that had engaged in a *Ponzi* scheme. *Id.* at *1. The Receiver filed an ancillary suit to recover Receivership Estate assets fraudulently transferred to the defendants. *Id.* The defendants filed a motion to dismiss the complaint, claiming that the North Carolina court lacked *in personam* jurisdiction over them as California residents without any contacts in that forum. *Id.* The Court noted that the Receiver had properly made § 754 filings in all California federal court districts where the defendants were located, which was "effective to extend the jurisdiction of this Court to any Defendants who have minimum contacts with California." *Id.* at *3, *citing Vision Comm., Inc.*, 74 F.3d at 291; *Terry*, 2003 WL 22125300 at * 3. This "extraterritorial jurisdiction" prevails in all ancillary cases except those of "extreme" inconvenience or unfairness. *Id.* at *4. Although a California resident might encounter some inconvenience by defending a suit in North Carolina, the Court held that this did not rise to the level of "extreme" inconvenience so as to implicate due process concerns. *Id.* Accordingly, the receivership court found that it did have *in personam* jurisdiction over the defendants in California. *Id.*

The case at hand is factually identical to *Quilling v. Grand Street Trust*. In this case, the Receiver was appointed on July 5, 2005. *Complaint* at ¶ 6. On July 11, 2005, within the ten-day period of § 754, the appropriate filings were made in the Central District of California, where the Defendants are located.[1] Because these filings fully comply with § 754, they effectively extend the

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A copy of (1) the transmittal letter, (2) the first page of the Complaint (bearing file mark), and (3) the first page of the Order Appointing Receiver, filed in the Central District of California pursuant to § 754 are submitted herewith as part of Exhibit A, the Affidavit of Michael J. Quilling. Although the Receiver recognizes that Motions to Dismiss are not ordinarily determined on outside evidence, he is including these materials so that the Court can confirm that all of § 754's filing requirements were met.

jurisdiction of this Court to any Defendants who have minimum contacts with that district. *See also Vision Comm., Inc.*, 74 F.3d at 291; *Terry*, 2003 WL 22125300 at *3. The Defendants in fact live in the Central District of California and service was made upon them there. *Complaint* at ¶¶ 2, 3. Thus, this Court has *in personam* jurisdiction over the Defendants. Furthermore, as in *Quilling v. Grand Street Trust*, any inconvenience in defending this litigation in the Northern District of Texas is not so extreme that it justifies disregarding the articulated policy of Congress that receivership claims be efficiently managed in a single forum.

C. Plaintiff's Complaint States a Proper Factual and Legal Basis for Relief.

1. Plaintiff's Complaint States a Claim Upon Which Relief Can be Granted.

The standards for considering a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) weigh heavily against dismissal. The Federal Rules of Civil Procedure expressly allow "notice pleading" in the form of "a short and plain statement of the claim showing that the pleader is entitled to relief . . . ." FED. R. CIV. P. 8(c). A Complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove "no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). In that regard, all well-pleaded facts in the complaint must be accepted as true and viewed in the light most favorable to the plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974); *Campbell v. San Antonio*, 43 F.3d 973, 975 (5th Cir. 1995).

Defendants mistakenly believe that the Receiver's claims should be dismissed because they are not legally cognizable, are improper, and are without basis in law or fact. *Defendants' Motion to Dismiss* at ¶ 7. To the contrary, this Court recognizes claims by the Receivership Estate to recover *Ponzi* scheme funds on behalf of the defrauded investors. *See, e.g., SEC v. Cook*, 2001 WL 256172, * 2 (N.D. Tex. Mar. 8, 2001). In fact, the Texas Uniform Fraudulent Transfer Act

("UFTA") clearly authorizes the very equitable claims that the Receiver seeks in this case, including (1) constructive trust and disgorgement, (2) fraudulent transfer, and (3) fees, expenses, costs, and interest. *See* TEX. BUS. & COM. C. § 24.008 and § 24.013 (granting Receivers the power to avoid transfers, seek costs, and obtain "other relief the circumstances may require."). Courts in the Northern District of Texas routinely grant judgments based on these very same causes of action. *See, e.g., Quilling v. Funding Resource Group*, 227 F.3d 231, 232-33 (5th Cir. 2000) (appeal arising from disgorgement relief that this Court granted relating to a *Ponzi* scheme); *Quilling v. Gilliland*, Case No. 3:01-CV-1617-BD, 2002 WL 373560 (N.D. Tex. Mar. 6, 2002) (voiding transfers of *Ponzi* scheme funds to family member). The Complaint sets forth facts in support of such relief which, when viewed in the light most favorable to the Receiver, at least raise a fact issue precluding dismissal in this case. *Scheuer*, 416 U.S. at 236. Accordingly, dismissal is improper under the standards of Rule 12(b)(6).

2. Plaintiff's Complaint Cannot Be Dismissed on the Basis of Federal Rule 9(b).

Federal Rule of Civil Procedure 9(b) requires all Complaints making averments of fraud to state the circumstances constituting fraud "with particularity." FED. R. CIV. PROC. 9(b). Clearly Rule 9(b) is not a basis for dismissal in this case because (1) case law entitles the Receiver to a more liberal pleading standard than that in Rule 9(b); (2) the *Ponzi* scheme establishes the circumstances of fraud as a matter of law; and (3) to the extent an "averment" of fraud is stated, the Complaint explains the fraudulent circumstances "with particularity."

a. Traditional Pleading Standards are Relaxed in Receivership Cases.

District courts have "broad powers and wide discretion" to fashion appropriate relief in equity receivership proceedings like the case at bar. *SEC v. Basic Energy & Affiliated Resources, Inc.*, 273 F.3d 657, 668 (6th Cir. 2001). That discretion includes the authority to use abbreviated,

summary processes that do not have to comply with the Federal Rules of Civil Procedure. *Id.*; *SEC v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992). In this case, the Receiver is entitled to a lower pleading standard as it relates to fraud because less detail is required of a Complaint when--as in this case--the information surrounding the allegations is "peculiarly within the knowledge of the defendant." *Cadle Co. v. Schultz*, 779 F.Supp. 392, 396 (N.D. Tex. 1991).

b. The Pleading Requirements of Rule 9(b) Do Not Apply Because Fraud is Presumed as a Matter of Law by the Mere Existence of a *Ponzi* Scheme.

Generally, the purpose of Rule 9(b) is to ensure that (1) the plaintiff has investigated and reasonably believes a fraud has occurred; (2) the defendants have adequate notice to respond to the claims; and (3) the defendants' reputation is protected. *Tuchman v. DSC Communications Corp.*, 818 F.Supp. 971, 977 (N.D. Tex. 1993), *affirmed* 14 F.3d 1061. However, when the existence of a *Ponzi* scheme is undisputed, the scheme's existence is "substantially established" and the Court presumes as a matter of law that payments in connection with the scheme were made with the intent to defraud. *S.E.C. v. Cook*, 2001 WL 256172, *3 (N.D. Tex. 2001) ("the debtor's intent to hinder, delay or defraud is established by the mere existence of the *Ponzi* scheme" as described in the Receiver's undisputed affidavit), *citing In re Independent Clearing House Co.*, 77 B.R. 843 (Bankr. D. Utah 1987).

In this case, the Receiver has clearly alleged that Stark used Sardaukar in carrying out a *Ponzi* scheme. *Complaint* at ¶ 8. The Defendants have not disputed the existence of this scheme for purposes of their Motion to Dismiss. *See Defendants' Motion to Dismiss*. Therefore, the pleadings and testimony before the Court substantially establish both the fraud's existence and Stark's fraudulent intent as a matter of law. Accordingly, this Court should not enforce the pleading requirement of Rule 9(b) when the fraud itself is not a central issue of dispute in the case.

c. Alternatively, Dismissal is Inappropriate Because the Complaint Satisfies Rule 9(b).

Even if Rule 9(b) did apply in this instance, the Complaint satisfies its pleading requirements by clearly setting forth all instances of fraud "with particularity." Rule 9(b) must is read in conjunction with Rule 8, which only requires the Complaint to give "fair notice" of the claim and the grounds on which it rests. *Cadle Co. v. Schultz*, 779 F.Supp. 392, 396 (N.D. Tex.1991). Rule 9(b) does not require a party to state all facts pertinent to a fraud action. *Mitchell Energy Corp. v. Martin*, 616 F.Supp. 924, 927 (S.D. Tex. 1985). Rather, a complaint satisfies the pleading requirements of Rule 9(b) if it specifies the period of time when the fraud took place, the location, the nature of fraud, and the parties involved in it. *Id.* at 927-28.

Under this standard, the Complaint in this case clearly satisfies Rule 9(b). It expressly alleges that Stark used investor funds to run a *Ponzi* scheme that operated in the early part of 2005. *Complaint* at ¶ 9. Stark ran this scheme out of an account at JPMorgan Chase Bank, N.A, and diverted funds from that bank to the Defendants in California. *Complaint* at ¶¶ 2, 3, 8. He also diverted funds to help discharge the Defendants' mortgage on their home (also located in California). *Complaint* at ¶ 8. The Complaint breaks down these transactions in great detail, including: (1) $26,001.13 transferred to John Stark; (2) $10,400.00 transferred to Barbara Stark; (3) $26,042.02 paid on John and Barbara Stark's behalf to March Community Credit Union on January 31, 2005; (4) $95,154.43 paid to GMAC Mortgage on March 18, 2005, for a home owned by John and Barbara Stark; and (5) at least $20,700.78 for John and Barbara Stark's trips to Europe. *Complaint* at ¶ 9. Therefore, to the extent that Rule 9(b) does apply, the Complaint cannot be dismissed because it describes Stark's fraudulent conduct with particularity.

WHEREFORE, PREMISES CONSIDERED, Plaintiff prays that the Court deny Defendants John and Barbara Stark's Motion to Dismiss and for such other and further relief, general or special, at law or in equity, to which he may show himself justly entitled.

Respectfully submitted,

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