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8 IN THE UNITED STATES DISTRICT COURT
9 EASTERN DISTRICT OF CALIFORNIA
10 SACRAMENTO DIVISION

11 SECURITIES AND EXCHANGE
12 COMMISSION
13 Plaintiffs

14 v.

15 SECURE INVESTMENT SERVICES, INC.,
16 AMERICAN FINANCIAL SERVICES, INC.,
LYNDON GROUP, INC., DONALD F.
NEUHAUS, and KIMBERLY SNOWDEN
17 Defendants

CASE NO.: 2:07-cv-01724 GEB CMK
**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
MOTION OF GORDON HARVEY
AND THE HARVEYH FAMILY
TRUST FOR LIMITED
INTERVENTION AND FOR RETURN
OF FUNDS**

[Notice of Motion and Motion of Gordon
Harvey for Limited Intervention and For
Return of Funds and Declarations of
Gordon Harvey and Robert D. Rowlett
filed concurrently herewith]

[Oral Argument Requested]

Date: March 9, 2009
Time: 9:00 a.m.
Judge: Garland E. Burrell, Jr.
Courtroom: 10

TABLE OF CONTENTS

1

2

3 Table of Authorities iii

4 Summary3

5 I. Background Facts4

6 A. The SEC Action and Freeze Order of August 24, 20074

7 B. Allegations Against Defendant Secure Investment Services.....5

8 C. Harvey’s Three Investments with Defendant SIS6

9 1. Harvey’s First Investment6

10 2. Harvey’s Second Investment.....6

11 3. Harvey’s Third Investment6

12 II. Arguments and Authorities8

13 A. Harvey’s Third Investment Funds Should be Returned Because it Was Not Part of the

14 Receivership Estate Until After Entry of the Freeze Order.....8

15 1. Harvey’s Check Was Not “Paid” Before Midnight, August 24.....8

16 2. The Receiver and this Court Previously Returned the Funds of Another Investor

17 Because her Check was not Finally Paid Until the Same Day as Mr. Harvey’s.....9

18 3. California’s UCC Specifically Defines When a Check is “Finally Paid”

19 4. Harvey’s Payment was Only Provisional at the Time of the Freeze order and

20 was Not “Finally Paid” Until at least Midnight August 24, 2007.....

21 5. The Freeze Order Should Have Prohibited the Receipt of Harvey’s Third

22 Investment Funds

23 6. Purpose of Freeze Order is to Maintain Status Quo.....

24 7. Funds Received After Freeze Order Cannot Become Part of Receivership

25 Estate.....

26 8. Harvey’s Third Investment Funds Were Not Commingled

27 B. Harvey Requested and is Entitled to Rescission of His Agreement with SIS

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- 1. Harvey is Entitled to a Contractual Right of Rescission.....
- 2. Harvey is Entitled to the Statutory Right of Rescission.....
- 3. The Receiver is Obligated to Honor the Terms of the Agreement
- C. This Case is Distinguishable from Other Cases Involving Ponzi Schemes
- D. Harvey’s Claims are Substantially Different and Entitled to Relief.....

Conclusion

TABLE OF AUTHORITIES

Cases

Allen v. Ramsay, 179 Cal. App. 2d 843, 854, 4 Cal. Rptr. 575 (1960)..... 7

Anderson v. Stephens, 875 F.2d 76 (4th Cir. VA 1986) 11, 12

CFTC v. Morgan, Harris & Scott, Ltd., 484 F. Supp. 669, 678-79 (S.D.N.Y. 1979)) 11

CFTC v. Muller, 570 F.2d 1296, 1300 (5th Cir. 1978)..... 11

Cunningham v. Brown, 265 U.S. 1, 44 S. Ct. 424, (1924) 13

FDIC v. O’Melveny & Myers, 61 F.3d 17(9th Cir. 1995) 7

In re Agricultural Research and Technology Group, Inc., 916 F.2d 528, 531
(9th Cir. 1990)..... 13

In Re Bengal Trading Corp., 12 B.R. 695 (Bankr. 1981)..... 12

In re Grafton Partners, L.P., 321 B.R. 527, (B.A.P. 9th Cir. 2005), 8

In re Vermont Real Estate Investment Trust, 25 B.R. 813 (1982) 12

Pupko v. Bank of America, 114 Cal. App. 3d 495, 170 Cal. Rptr. 615
(Cal. App. Dist. 4 1981) 9

Rosenberg v. Collins, 624 F.2d 659, 663 (5th Cir. 1980)..... 13

SEC v. Elliott, 953 F.2d 1556, 953 F.2d 1560 (11th Cir. 1992) 15

State Bank v. Stallings, 427 P.2d 744 (Utah 1967)..... 10

United States v. Durham, 86 F.3d 70 (5th Cir. 1996) 13

Statutes

Cal. Civ. Code § 1689..... 1, 6

Cal. U. Com. Code § 4215(a)(3)..... 9, 10

Cal. U. Com. Code § 4301(a) 10

Cal. U. Com. Code § 4303(a) 10

1 Cal. U. Com. Code §§4104(a)(10)..... 10
2 Fed. R. Civ. P. Rule 24 5
3
4 **Treatises**
5 Restatement (First) of Restitution §211(1)(1937)..... 13
6 Restatement of Restitution § 213(2) 12

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1 Gordon M. Harvey, through his counsel, submits this Memorandum of Points and Authorities in
2 Support of Motion for Limited Intervention and for Return of Funds in the amount of his third
3 investment of Two Hundred Thousand Dollars (\$200,000.00) held by Michael Quilling, the Court
4 appointed receiver in this matter (the "Receiver").

5
6 **SUMMARY**

7 Gordon M. Harvey ("Harvey") is a three time victim of an investment scheme perpetrated
8 by Defendant Secure Investment Services, Inc. ("SIS"). Harvey personally made three separate
9 investments with SIS with the first investment of \$300,000 being made in 2006 and the second
10 investment of \$10,000 being made later that year. Harvey's third and final investment of
11 \$200,000 (the "Third Investment") was deposited with Wells Fargo Bank on August 22, 2007 for
12 payment to Defendant SIS.

13 Harvey's Third Investment, however, and the claims set forth in this Motion concerning
14 the Third Investment are different from those of his first two investments and of the other parties
15 that invested with Defendants SIS. As a result, Harvey is entitled to relief and prompt return of
16 his Third Investment funds in the amount of \$200,000 for at least the following reasons:

17
18 • Harvey's investment and payment of funds for his Third Investment was not final
19 nor actually paid to SIS until after the freeze order had been entered in this case. This result is
20 mandated by the California Uniform Commercial Code, Division 4 (Bank Deposits and
21 Collections) as applicable to the collection and payment of Mr. Harvey's check no. 1032 to SIS.
22 As a result, Harvey's Third Investment funds were not properly part of the receivership estate at
23 the time of the freeze order and should not now be deemed a part of the Receiver's estate.

24
25 • The Receiver and this Court previously returned the investment funds of another
26 California Investor whose investment check was cashed and paid the same day as Mr. Harvey's.
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1 [See Stipulation and Order filed in this Case, Ct. Docket No. 343]. In that case, the Investor's
2 check was submitted to the Defendant SIS's bank for cashing the exact same day as Mr. Harvey
3 submitted his. According to California law, neither the other investor nor Mr. Harvey's checks
4 were finally paid until after this Court entered the Asset Freeze order and thus Mr. Harvey's
5 Third Investment check should be returned just like the other investor.

6
7 • According to the specific terms of his investment contract with SIS, Harvey was
8 entitled to cancel or rescind the contract, for any reason, within 10 days of his payment of
9 investment funds to SIS. Harvey timely exercised this right to cancel and rescind his Third
10 Investment through SIS. The Receiver should be required to abide by the terms of the investment
11 contract and return Harvey's Third Investment funds that he paid to SIS.

12
13 • Unlike the majority of other investors with Defendants SIS, Harvey failed to
14 receive any consideration for his Third Investment funds or for entering into the investment
15 contract with SIS and therefore is entitled to rescind the contract pursuant to Cal. Civ. Code §
16 1689 and seeks to do so.

17
18 • Harvey's monies can clearly be traced to him and were never commingled with the
19 funds of other investors.

20
21 • Because Harvey's investment funds and claims are unique and distinguishable
22 from all other investors with SIS, he is entitled to be treated differently than those, more similarly
23 situated, investors.

24
25 **I.**
BACKGROUND FACTS

26
27
28 **A. The SEC Action and Freeze Order of August 24, 2007.**

1 1. On about August 23, 2007, the Securities and Exchange Commission (“SEC”)
2 filed a complaint in the present action (the “Complaint”) alleging, in part, that Defendants Donald
3 Neuhaus and Kimberly Snowden had been operating a Ponzi scheme through various
4 corporations, including Secure Investment Services, Inc. (hereafter referred to collectively as
5 “Defendants” or “SIS”) since 2001. [See Complaint filed August 23, 2007]

6 2. On August 24, 2007, a Temporary Restraining Order and Order to Show Cause
7 Re: Preliminary Injunction and an Order Appointing Temporary Receiver was entered. [See
8 Temporary Restraining Order and Order to Show Cause Re: Preliminary Injunction and Order
9 Appointing Temporary Receiver] The Order Appointing Temporary Receiver further contained a
10 “freeze order” (“Freeze Order”) which, in pertinent part, ordered a freeze of all Receivership
11 Entities assets, including any bank accounts. The Freeze Order specifically restrained and
12 enjoined the Receivership Entities or their agents, etc. from, “directly and indirectly, transferring,
13 setting off, receiving, changing, selling, pledging, assigning, liquidating or otherwise disposing of
14 or withdrawing” any assets (emphasis added). [See Order Appointing Temporary Receiver, ¶ 3]

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16
17 **B. Allegations Against Defendants Secure Investment Services, Inc.**

18 3. The SEC Complaint alleges that Defendants offered and sold securities in the form
19 of fractionalized interests in life insurance policies. [See Complaint] Investors would invest
20 certain monies which would then be tied to a portion of a specific policy. [Id.] Investors were
21 provided with life expectancy estimates on the insured, purportedly signed by a medical doctor.
22 [Id.] The investors would be listed as beneficiaries and owners with the life insurance company
23 on the policy in which they invested. [Id.] The investment was intended to cover the policy
24 premiums for their portion of the policy for the remainder of the life expectancy of the insured
25 plus the bond waiting period (typically twelve months). [Id.] Defendants were to retain funds to
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1 continue to pay the policy premiums until the policy matured or the bond company paid out. [*Id.*]
2 When a policy matured, each investor in that policy would receive a pro rata share of the policy
3 face amount that equaled his or her original investment plus the return. [*Id.*]

4 4. The Complaint further alleges, among other things, that Defendants did not retain
5 enough funds to pay future policy premiums, but instead spent funds on personal and business
6 expenses and relied on new investments to pay policy premiums of earlier investors, thereby
7 operating a “Ponzi” scheme. [*Id.*] And that Defendants resorted to using a portion of the cash
8 value of some policies and new investor funds to meet prior policy obligations. [*Id.*, ¶¶ 17, 19]

9
10 5. Prior to the appointment of the Receiver in August of 2007, Defendants had
11 allowed only one policy to lapse, which lapse was recent enough to the commencement of this
12 action as to allow the Receiver to have the policy reinstated. [*See* Receiver’s Response to Docket
13 No. 135, ¶ 4(j), filed April 21, 2008]

14 6. Of interest, Defendant Neuhaus and his wife Linda, held partial ownership
15 interests in policies in their own name. [*See* Compromise and Settlement Agreement, ¶ 3, filed
16 10/29/2007]

17
18 **C. Harvey’s Three Investments with Defendant Secure Investment Services, Inc.**

19 **1. Harvey’s First Investment.**

20 7. On about June 6, 2006, Limited Intervener Gordon Harvey executed a Master
21 Purchase Agreement and Purchase Addendum with Defendant SIS. [*See* Declaration of Gordon
22 Harvey (“Harvey Dec.”), p2]. At about the same time, Harvey deposited personal funds in the
23 amount of three hundred thousand dollars (\$300,000) with SIS (“Harvey’s First Investment”). *Id.*,
24 p.3. This Motion does not address nor seek recovery of Harvey’s First Investment.

25
26 **2. Harvey’s Second Investment.**

1 8. Thereafter, on about November 30, 2006, Harvey made a second investment with
2 SIS. *Id.* At that time, Harvey deposited personal funds in the amount of \$10,000 with SIS
3 (“Harvey’s Second Investment”). *Id.* This Motion does not address nor seek recovery of
4 Harvey’s Second Investment.

5 **3. Harvey’s Third Investment.**

6 9. In summer of 2007, SIS informed Harvey of a new policy that would soon be
7 available for investment. According to information he received from SIS, the new policy was to
8 be more attractive than many of the prior policies. *Id.*, p___. Interested, Mr. Harvey entered into
9 an amendment to the Master Purchase Agreement and Purchase Addendum with SIS setting forth
10 the terms of any new investments offered by SIS. *Id.*, p__.

11 10. On August 22, 2007, Harvey deposited personal funds, using his check number
12 1032, in the amount of two hundred thousand dollars (\$200,000) with Wells Fargo Bank for the
13 benefit of SIS (“Harvey’s Third Investment”). *Id.*, p.6, Exhibit “3.” This Motion is solely
14 directed to Harvey’s Third Investment.

15 11. Harvey’s Third Investment was received by Bank of America (Harvey’s bank or
16 payor bank) on August 23, 2007. *Id.* The check was posted and provisionally settled by Bank of
17 America with the provisional settlement occurring on or after the evening of August 23, 2007.
18 [*Id.*]. The settlement for Harvey’s check did not become final, however, until after midnight on
19 August 24, 2007 and was not “finally paid” until after that time and the entry of the “freeze
20 order.” *See* Declaration of Robert D. Rowlett (“Rowlett Dec.”), p 5-8 and Exhibit 2.

21 12. Mr. Harvey was unaware of any actions by the SEC against SIS until after 5:00
22 p.m. on August 24, 2007, when he received an urgent telephone call from Mr. John “Jack”
23 Hradesky (“Hradesky”) informing him of the SEC action and urging him to cancel his check and
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1 Third Investment. Harvey Dec., p___. Harvey attempted to stop payment on the check later that
2 night using an after hours telephonic bank support line, but was not successful.

3 13. Harvey then communicated with Mr. Hradesky over the weekend directly
4 requesting that his contract with SIS be rescinded or cancelled with respect to his Third
5 Investment and that he wanted his payment for the Third Investment immediately returned. *Id.*,
6 p___. Mr. Hradesky informed Harvey that he had spoken with Defendant Donald Neuhaus and
7 that SIS would refund his Third Investment as soon as he was allowed to do so. *Id.*, p___.
8

9 14. Thereafter, Harvey was also informed that Defendant SIS had not yet assigned his
10 Third Investment funds to an insurance policy, that the funds had not been moved from the SIS
11 account and that SIS would return the funds if possible. *Id.*, p___.
12

13 15. Harvey has never received any documents or written communications from SIS
14 after he deposited his Third Investment funds. Specifically, Harvey never received any closing
15 documents in connection with his Third Investment. Moreover, Harvey has not received any
16 payment, refund, interest, return of funds or other amount in connection with his Third
17 Investment. *Id.*, p___.
18

19 **II.**
ARGUMENTS AND AUTHORITIES

20 **A. Harvey's Third Investment Funds Should Be Returned Because They Were**
21 **Not Part Of The Receivership Estate Until After Entry Of The Freeze Order.**
22

23 **1. Harvey's Check Was Not "Paid" Before Midnight, August 24, 2007.**

24 16. Harvey's Third Investment check no. 1032 was received by Wells Fargo Bank on
25 August 22, 2007 and submitted to Bank of America (the "payor bank") for payment the next day,
26 August 23, 2007. Pursuant to banking rules and the California Uniform Commercial Code,
27 Harvey's check was not finally paid and the funds not actually available to Wells Fargo until at
28

1 least midnight the next day or midnight August 24, 2007. Because the funds were not available
2 to Wells Fargo and thus not part of the Receivership estate until after entry of the freeze order,
3 they should be returned to Mr. Harvey.

4 **2. The Receiver Has Previously Returned an Investor's Check Because It Was**
5 **Not "Finally Paid" until after the Freeze Order.**

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7 17. The Receiver and this Court previously returned the investment funds of another
8 Investor whose investment check was deposited with Defendant SIS bank and paid the same day
9 as Mr. Harvey's. Having the nearly exact same facts and applicable California law as that
10 investor, Mr. Harvey's Third Investment funds should be ordered returned similarly to the order
11 entered by this Court for the similarly situated investor.

12 18. Specifically, Ms. Elke Katsuren, a California resident also invested with
13 Defendant Secure Investment Services, Inc. ("SIS"). Ms. Katsuren's funds, however, have been
14 returned by the Receiver and SEC because her investment check to Defendant SIS was not finally
15 paid until after entry of the Asset Freeze Order in this Action on August 24, 2007. The Receiver
16 and the Examiner, through their own counsel agreed and even stipulated, at this Court's Docket
17 343, to return Katsuren's funds for that reason and based on California law. [*See* Rowlett Dec., p
18 3-4, Ex. 1]. Similar to Ms. Katsuren, Mr. Harvey's check and funds which he seeks returned,
19 were deposited on the same day as Ms. Katsuren's and at the same California Bank (different
20 branch) and subject to the same interbank check cashing laws and regulations, and thus was not
21 finally paid until the same time or later than Ms. Katsuren's. [*Id.*, p. 3-4. Ex. 1, Stipulation and
22 Order filed in this Case, Ct. Docket No343]. In that case, the Investor's check was submitted to
23 her bank (Downey Saving and Loan) for cashing the exact same day as Mr. Harvey. *See*
24 Declaration of Elke Katsuren, Docket No. ____].
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1 **3. California’s UCC Specifically Defines When a Check is “Finally Paid.”**

2 19. The issue of when a check is actually paid and the funds the property of the payee
3 (here, the Receiver’s estate on behalf of Defendant SIS) is an important banking issue and has
4 been specifically addressed and made clear by the courts and the California Uniform Commercial
5 Code, Division 4, entitled Bank Deposits and Collections (“Cal U. Com. Code”). Typically, and
6 relevant here, a check is first submitted to the payor bank for payment. The California payor
7 bank then processes (posts) the check which automatically allows for a provisional settlement.
8 After receipt and the provisional settlement, the payor bank then has until its midnight deadline
9 (midnight the next day) to revoke the provisional settlement or the check is finally paid. As set
10 forth in the Cal. U. Com. Code §4125:
11

12 (a) An item is finally paid by a payor bank when the bank has first done any
13 of the following: (1) (2) ... (3) Made a provisional settlement for the
14 time and failed to revoke the settlement in the time and manner permitted by
15 statute, clearing house rule, or agreement. (b) If provisional settlement for
16 an item does not become final, the item is not finally paid. *See* Cal. U. Com.
17 Code §4125 (cited only in part).

18 Section (b) and Paragraph 6 of the Official Comments to this section clarify that “final payment”
19 occurs at the time of the expiration of the deadline to revoke and not at the time of the provisional
20 settlement.

21 20. California courts have also clarified that the mere recording or posting of a check
22 by a payor bank does not constitute payment. *See Pupko v. Bank of America*, 114 Cal. App. 3d
23 495, 499. Nor does the stamping of a check “paid” by the payor bank constitute final payment.
24 *Id.*

25 21. Under Cal. U. Com. Code §4302, once a check is received by a payor bank for
26 payment, the bank is accountable for the amount of the check if the bank retains the check
27
28

1 beyond midnight of the banking day of receipt without settling for it or, does not pay or return the
2 item or send notice of its dishonor until after its midnight deadline.

3 22. Midnight deadline with respect to a bank is defined by Cal. U. Com. Code §4104,
4 entitled Definitions, as midnight on the payor bank's next business day on which it receives the
5 relevant item (check) or notice from which the time for taking action commences to run,
6 whichever is later. Cal U. Com. Code §4104(a)(10) Here, the midnight deadline for payment of
7 Mr. Harvey's check was midnight the next day, or August 24, 2007, after entry of the Freeze
8 Order.
9

10 **4. Harvey's Payment Was Only Provisional at the Time of The Freeze Order**
11 **and was Not Finally Paid until at least Midnight on August 24, 2007.**

12 23. Harvey's Third Investment was made using check number 1032 drawn from his
13 Bank of America account. Check no. 1032 was received and posted by paid by Bank of America
14 (the payor bank) on August 23, 2007 and was also automatically provisionally settled that same
15 day. Rowlett Decl., ¶ 5, Ex. 2, *See also* Cal. U. Com. Code § 4301(a). As set forth above, under
16 the California Uniform Commercial Code and typical interbank check cashing procedures, Bank
17 of America then had until midnight the next day or midnight, August 24, 2007 to notice its intent
18 to return the item or finally pay it. *See* Cal. U. Com. Code §§4104(a)(10) and 4215(a)(3).
19

20 24. As also set forth above, until a check has been "finally paid" the credit for such
21 funds is merely "provisional" and is not yet the property of the payee (receiving bank or its
22 customer). *Id.*, §§4104(a)(11), 4201,4215, and 4302(a). Thus, under the present facts, settlement
23 for Harvey's Third Investment check did not and could not become final (or paid) until at least
24 midnight on August 24, 2007, after this Court's Freeze Order was entered and effectuated.
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1 25. The provisional status of the funds at the time the freeze order was issued is
2 further evidenced by Harvey's right to stop payment of the funds on August 24, 2007. Cal. U.
3 Com. Code § 4303(a) states in pertinent part:

4 Any ... stop-payment order received by... a payor bank comes too late ... if the
5 ... stop-payment order... is received ... and a reasonable time for the bank to act
6 thereon expires or ... after the earliest of the following:

7 ...
8 (5) With respect to checks, a cutoff hour no earlier than one hour after the
9 opening of the next banking day after the banking day on which the bank received
10 the check and no later than the close of that next banking day or, if no cutoff hour
11 is fixed, the close of the next banking day after the banking day on which the bank
12 received the check. [portions omitted] (emphasis added)

13 Therefore, Harvey had until at least one hour after the opening of the banking day
14 on August 24, 2007, to stop payment of his check. Other jurisdictions have stated that the power
15 to stop payment may be used to determine whom the funds belong. *State Bank v. Stallings*, 427
16 P.2d 744 (Utah 1967).

17 **5. The Freeze Order Should Have Prohibited the Receipt of Harvey's Funds.**

18 26. The Freeze Order appointing the Receiver was entered on August 24, 2007 and
19 ordered an immediate freeze of all assets of the defined receivership entities. [See Order
20 Appointing Temp. Receiver] Specifically, in pertinent part, it ordered,

21 "The Receivership Entities, their respective officers, managers, trustees, escrow
22 agents, facilitators, agents, servants, employees, attorneys, and all other persons
23 in active concert or participate with them, are hereby restrained and enjoined
24 from, directly and indirectly, transferring, setting off, receiving, changing,
25 selling, pledging, assigning, liquidating or otherwise disposing of or
26 withdrawing any assets and property owned by, controlled by, or in possession
27 of the Receivership Entities. This freeze shall include, but not be limited to,
28 those funds located in any bank accounts."

29 Therefore, the Freeze Order specifically prohibited Wells Fargo from receiving Harvey's Third
30 Investment funds. Specifically, under the explicit terms of the Freeze Order, Wells Fargo was not
31 authorized to allow the provisional credit of Harvey's Third Investment to be finally paid into the

1 SIS account nor was the Receiver allowed to receive those funds as part of the Receiver's estate.
2 Although unauthorized by the Freeze Order, the transfer likely occurred because it was an
3 automated transaction.

4
5 **6. Purpose of Freeze Order is to Maintain Status Quo.**

6 27. The provisional status of the funds at the time the freeze order was is The purpose
7 of a federal receivership is to maintain the status quo, prevent the further dissipation of assets and
8 protect future potential investors from becoming victims of the receivership entities' fraudulent
9 activities. *Anderson v. Stephens*, 875 F.2d 76 (4th Cir. VA 1986) (Receiver argued that the
10 purpose of a freeze order was to maintain the status quo and prevent additional losses to
11 customers. *Citing CFTC v. Muller*, 570 F.2d 1296, 1300 (5th Cir. 1978); *CFTC v. Morgan,*
12 *Harris & Scott, Ltd.*, 484 F. Supp. 669, 678-79 (S.D.N.Y. 1979)).

13 28. The Freeze Order entered by this Court sought to uphold the purpose of a
14 receivership by freezing the assets of the Receivership Entities and preventing the receipt of or
15 changing of any assets under the possession or control of the Receivership Entities or their
16 agents.

17
18 **7. Funds Received After Freeze Order Cannot Legally Become Part of**
19 **Receivership Estate.**

20 29. The provisional status of the funds at the time the freeze order was is Several
21 courts have determined that funds deposited after a freeze order is issued cannot legally become
22 part of the receivership assets. *See Anderson v. Stephens*, 875 F.2d 76 (4th Cir. VA 1986)
23 (Checks deposited after freeze order were to be returned to investors. Freeze order was
24 ambiguous but purpose was clearly to stop all activity in account and maintain status quo.) *Citing*
25 *In re Vermont Real Estate Investment Trust*, 25 B.R. 813 (1982) and *In Re Bengal Trading Corp.*,
26 12 B.R. 695 (Bankr. 1981). *See also SEC v. Elliott*, 953 F.2d 1556 (11th Cir. 1992) (Citing
27

1 *Anderson v. Stephens*, held that checks did not become part of the account because they could not
2 legally be deposited after freeze order went into effect.)

3 30. As demonstrated above, Harvey's Third Investment funds were not part of the
4 Receivership estate because Harvey's Third Investment check was not "finally paid" at the time
5 the Freeze Order was issued. Thus, those funds were not part of the Receivership assets and
6 could not become so after the Freeze Order was issued. Therefore, Harvey is entitled to an
7 immediate refund of his entire Third Investment.
8

9 **8. Harvey's Funds Were Not Commingled.**

10 31. The provisional status of the funds at the time the freeze order was is Restatement
11 of Restitution § 213(2) provides that "Where the wrongdoer has effectively separated the money
12 of one of its claimants, that claimant is entitled, and only to, his own money or its product."
13 Here, Harvey's Third Investment funds were clearly "separated" from the funds of the other
14 investors. Harvey's funds were never "commingled" with the funds of the other investors, in fact,
15 Harvey's Third Investment funds were never even available to SIS because the Freeze Order was
16 in place prior to those funds ever being finally paid. Likewise, because Harvey's Third
17 Investment was never part of the SIS account until after the Freeze Order, Harvey can clearly
18 trace his funds.
19

20 32. Although trial Courts have rejected the principles of commingling and tracing on
21 equitable grounds in cases where the claimants were similarly situated, tracing is still permissible.
22

23 Typically, when a party can trace its assets that party is entitled to seek a
24 constructive trust or equitable lien on its portion of those funds that remain.
25 Restatement (First) of Restitution §211(1)(1937); *Cunningham v. Brown*, 265
26 U.S. 1, 11, 44 S. Ct. 424, 426 (1924) (discussing the infamous Ponzi scheme) A
27 constructive trust may be created regardless of the intentions of the parties "where
28 equity and Justice demand." *Rosenberg v. Collins*, 624 F.2d 659, 663 (5th Cir.
29 1980).

1 *United States v. Durham*, 86 F.3d 70 (5th Cir. 1996). This present case is a perfect example of
2 when these equitable remedies should be allowed. With the exception of Elke Katsuren whose
3 investment funds were previously returned for the reasons set forth in this Motion, Harvey's
4 claims are substantially different from all other investors with SIS. In fact one would be hard
5 pressed to find a clearer case of traceability as the Receiver could literally trace the funds as they
6 cleared into the SIS account. As such the Court, acting in equity, should permit Harvey to invoke
7 the equitable remedies of tracing and a constructive trust and order a return of his funds.
8

9 **9. Receiver Stipulated to Return Katsuren Funds.**

10 33. This is because I previously represented another investor, Elke Katsuren, who, like
11 the present limited intervenor, Mr. Harvey, invested with Defendant Secure Investment Services,
12 Inc. ("SIS"). Ms. Katsuren's funds were returned by the Receiver and SEC because her
13 investment check to Defendant SIS was not finally paid until after entry of the Asset Freeze Order
14 in this Action on August 24, 2007. The Receiver and the Examiner, through their own counsel
15 agreed and even stipulated, at this Court's Docket 343, to return Katsuren's funds for that reason
16 and based on California law. Similar to Ms. Katsuren, Mr. Harvey's check and funds which he
17 seeks returned, were deposited on the same day as Ms. Katsuren's and at the same California Bank
18 (different branch) and subject to the same interbank check cashing laws and regulations, and thus
19 was not finally paid until the same time or later than Ms. Katsuren's.
20

21 **B. Harvey Is Entitled To Rescission of His Purchase Addendum.**

22 **1. Contractual Right of Rescission**

23
24 34. The Purchase Addendum provides for a 10 day right of rescission, beginning at the
25 time SIS received the investment funds. *See* Harvey Decl., Exhibit 2, ¶ 4. Harvey did not
26
27
28

1 provide any funds to SIS until August 21, 2007 at the earliest. *Id.* On August 24, 2007 Harvey
2 exercised his right to rescind the Purchase Agreements by noticing Mr. Hradesky. *Id.*

3 **2. Statutory Right of Rescission for Failure of Consideration**

4 35. Section 1689 of the California Civil Code provides for rescission of a contract
5 based on, among other things, failure of consideration.

6
7 Cal. Civ. Code § 1689(b)(4) states:

8 (b) A party to a contract may rescind the contract in the following cases:

9 (2) If the consideration for the obligation of the rescinding part fails, in whole or
10 in part, through the fault of the party as to whom he rescinds.

11 (3) If the consideration for the obligation of the rescinding party becomes entirely
12 void from any cause.

13 (4) If the consideration for the obligation of the rescinding party, before it is
14 rendered to him, fails in a material way.

15 36. Unlike other earlier investors, the policy Harvey contracted for, on the life of
16 ALT-R, was never purchased. *See* Exhibit 1 to Receiver's Interim Report dated April 30, 2008.
17 Pacific Life Insurance Company issued the life insurance policy on ALT-R *Id.* They were one of
18 the insurance companies who allowed the multiple owner policies to be held in the name of the
19 individual investors. *See* Exhibit 3 to the Receiver's Interim Report dated April 30, 2008. Had
20 Harvey's policy actually been purchased, Harvey would be similarly situated to those investors
21 who were given the option of opting out of the Receivership Estate. These investors are not
22 legally required to turn over their ownership interests to the receivership. They have the option of
23 paying the remaining premiums themselves and obtaining the percentage of their ownership
24 interest when the policy matures, which will likely far exceed the pro rata distribution
25 contemplated by the Receiver. Some have exercised this option, as evidenced by the Receiver's
26 motions to cease making payments of premiums on those policies. Those investors have the
27

1 choice of whether to risk paying additional premiums out of their pocket in anticipation of a
2 much larger return, or to allow themselves to become part of the Receivership Estate. Because
3 Harvey did not receive the consideration (his ownership interest in the life insurance policy) he
4 has been denied this option.

5 **10. SIS Not a Ponzi Scheme.**

6 37. The facts of this case are not representative of a typical “Ponzi” scheme. The
7
8 Courts have defined a “Ponzi” scheme as follows:

9 A Ponzi scheme is an arrangement whereby an enterprise makes payments to
10 investors from the proceeds of a later investment rather than from profits of the
11 underlying business venture, as the investors expected. The fraud consists of
12 transferring proceeds received from the new investors to previous investors,
13 thereby giving other investors the impression that a legitimate profit making
14 business opportunity exists, where in fact no such opportunity exists. *See*
15 *Cunningham v. Brown*, 265 U.S. 1, 44 S. Ct. 424, (1924)

16 *In re Agricultural Research and Technology Group, Inc.*, 916 F.2d 528, 531 (9th Cir. 1990). Here,
17 a legitimate profit making business opportunity did in fact exist. According to the Receiver, the
18 Defendants have taken in approximately \$25 million from their investors since 2001. [*See*
19 *Complaint*, ¶ 2] The death benefits of the policies purchased by SIS, either in its name or in the
20 names of its investors, exceed \$49 million. [*See Exhibit 1 to Receiver’s Interim Report for the*
21 *Period Ended April 30, 2008*] The future policy premiums through the life expectancy and bond
22 waiting periods of the insureds was approximately \$3.1 million dollars when the SEC filed its
23 action. [*See Complaint*, ¶ 18] Although we are not privy to the amounts already paid in premiums
24 by the Defendants, it is unlikely that it exceeded \$20 million dollars. Therefore, had SIS continued
25 to meet its obligations, its business would likely have been profitable and its investors would have
26 secured their profits thereby creating a profit for the business and its investors, had SIS continued
27 to meet its obligations.

1 38. One of the defining characteristics of a Ponzi scheme is the transferring of proceeds
2 received from new investors to previous investors in the form of “returns” on their investments.
3 Here, the SEC alleges that Defendants used the funds of new investors to pay policy premiums and
4 other business expenses of previously sold policies. *See* Complaint, ¶ 17. Using funds obtained
5 from new contracts to meet previous obligations, while not sound business practice, is not
6 tantamount to paying fraudulent “returns” on investment with the money of new investors.
7

8 39. Additionally, the defendants were actually operating the business they portrayed to
9 investors. It has not been alleged, and indeed the Receiver has evidenced through various filings
10 with this Court, that prior to the filing of this action by the SEC, the insurance policies invested in
11 by the investors were in fact purchased. *See* Exhibit 1 to Receiver’s Interim Report for the Period
12 Ended April 30, 2008. Ownership interests in those policies were placed in the names of the
13 individual investors, when allowed by the policies and procedures of the insurance companies. *See*
14 Exhibit 3 to Receiver’s Interim Report for the Period Ended April 30, 2008. This is dissimilar to
15 the majority of “Ponzi” cases, where the Defendants do not actually engage in the purported
16 investment vehicle they advertise, or do so only on a very limited basis.
17

18 40. In the majority of Ponzi scheme cases, the sole intent of the Defendants was to
19 defraud their investors and abscond with as much money as possible. The investors did not receive
20 any consideration for their investments, other than fraudulent returns which were paid with new
21 investors’ money. That is not the case here. Here, the investors actually received fractionalized
22 interest in the life insurance policies for which they contracted. Here, the Defendants were
23 actually operating the business they portrayed to investors. Here, the investors actually stood the
24 chance of realizing a legitimate return on their investment. It would be a waste of the Court’s time
25 and resources for Intervenor to cite every Ponzi scheme case and distinguish it from the facts
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27
28

1 herein. However, she respectfully requests that this Court, as it reviews the decisions in other
2 cases, keep in mind that the facts of those cases are materially different from the facts herein and
3 that the rules generally applied in alleged Ponzi scheme cases should not necessarily be applied
4 herein.

5
6 **CONCLUSION**

7 41. For all of the reasons set forth above, including because the Receiver and the
8 Examiner previously stipulated to the same for another investor and because Harvey is different
9 from other investors, both in the present case and in previous cases dealing with alleged Ponzi
10 schemes. Harvey is entitled to a full release and return of his Third Investment funds.

11
12 DATED: February 6, 2009

ROWLETT LAW GROUP

13
14 /s/Robert Rowlett/
15 ROBERT D. ROWLETT
16 Attorney for Intervener Gordon Harvey
17 and the Harvey Family Trust
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