IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

FILED IN CHAMBERS
THOMAS W. THRASH JR.
U.S.D.C. Atlanta

SEP 14 2000

LUTHER D. THOMAS, Clerk
By: [signature]
Deputy Clerk

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MARK DRUCKER,

Defendant

and

MICHAEL WEINSTOCK,
Relief Defendant.

CIVIL ACTION FILE
NO. 1:99-CV-2687-TWT

ORDER

This is a securities fraud enforcement action. It is before the Court on Relief Defendant Michael Weinstock's Motion to Dismiss [Doc. 20], Plaintiff's Motion for Summary Judgment [Doc. 22], and Plaintiff's Motion for Entry of Default Judgment Against Defendant Michael Drucker [Doc.48]. For the reasons set forth below, the Court denies as moot Relief Defendant Michael Weinstock's Motion to Dismiss, denies as moot Plaintiff's Motion for Summary Judgment, and grants Plaintiff's Motion for Entry of a Default Judgment Against Defendant Michael Drucker.

I. BACKGROUND

The case involves the amalgamation of an age-old investment swindle, the Ponzi scheme, with today's latest "get rich quick" investment fad, day trading. Named for Charles Ponzi, who ran such a scheme in 1919-20, a Ponzi scheme is an investment plan in which promised returns are paid to earlier investors from money later investors pay into the scheme. Thus, the life of the scheme depends on the operator continuously luring new investors into the scheme. Ponzi schemes are similar to pyramid schemes but, unlike pyramid schemes, are operated by one central entity or person. Day trading is a practice whereby an investor makes numerous trades via the Internet in an attempt to score large profits, often from the minute rises and falls that typically occur to a security in a single day. Hence, the term "day trading."

Plaintiff Securities & Exchange Commission ("SEC"), the administrative agency of the United States government charged with enforcing the nation's securities laws, alleges that Defendant Mark Drucker represented to investors that he could earn them large financial returns, when in reality Drucker consistently was losing money and running a Ponzi scheme. According to Plaintiff, Drucker covered up the Ponzi scheme's losses by shifting to earlier clients those funds that later clients invested. This sleight of hand made it appear to the earlier clients that their investments with Drucker were making money. Plaintiff has named Michael Weinstock as a Relief

Defendant on grounds that Weinstock was unjustly enriched as one of the investors who financially benefitted from the Ponzi scheme. Plaintiff contends that the profits Weinstock received should be turned over to the SEC to reimburse those investors who lost money in Drucker's Ponzi scheme.

Drucker began his Ponzi scheme in July 1998. In soliciting potential investors, Drucker explained that the funds would be invested in securities through a brokerage account ("the Ponzi account") in Drucker's name at Fidelity National Capital Investors, Inc. ("Fidelity"), a securities brokerage firm. Drucker told investors that he used a complex mathematical formula or computer program to make his trading decisions. Many of the investors signed Management Agreements. These Management Agreements typically provided that the investor's initial investment would be deposited in Drucker's brokerage account and that Drucker would have full and complete discretion to invest, trade and otherwise make transactions associated with the account. The Management Agreements also typically stated that an investor would receive $30,000 on or about 60 days after the initial investment. Some Management Agreements promised even larger returns over shorter periods. This was especially true with Management Agreements entered into when an investor made subsequent deposits to the fund. For example, Weinstock's Fifth Management Agreement

promised a 50% return in two weeks, and his Sixth Management Agreement promised a 100% return in 60 days.

In an attempt to keep the Ponzi scheme afloat, Drucker engaged in significant amounts of day trading with the investors' funds. For example, in May 1999 Drucker bought and sold approximately $6 million of securities. During the next two months, his trading intensified. Drucker bought and sold approximately $9 million of securities in both June and July of 1999. His trading volume for August, 1999, returned to $6 million, still a substantial amount. Unfortunately for him and his investors, Drucker lost more money day-trading than he earned. For the calendar year 1999, the only profitable months for the Ponzi account were January, 1999, when it made $82,834 in profit and March, 1999, when it made $185,890 in profit. Overall, Drucker lost approximately $225,660 from day trading before 1999 and an additional $634,453 in 1999.

Since Drucker was losing money day trading, he was forced to dip into later investors' funds to provide earlier investors the financial returns he had promised them. For example, in late July 1999, Drucker used new funds deposited in the Ponzi account to purchase a Ferrari for one of his earlier investors. On July 23, 1999, Drucker wrote a $10,000 check to Ferrari of Atlanta. Over the next seven days, eight investors provided the Ponzi account with another $181,000 in contributions. On July

30, 1999, Drucker wired $143,982.95 to Ferrari of Atlanta from the Ponzi account despite the fact that this would leave only $68,832.43 in the account, and also despite the fact that the account incurred $208,753 in trading losses for the month of July. In short, Drucker used the funds provided by eight new investors to purchase the Ferrari for an earlier investor who expected some sign that his investment was reaping financial rewards. Without the infusion of new funds, Drucker would not have been able to purchase the Ferrari from the Ponzi account.

Another example of this financial "hide-and-seek" shows how Relief Defendant Weinstock financially benefitted from the Ponzi scheme at the expense of other investors. On August 13, 1999, an investor wired $550,000 into the Ponzi account. Prior to this wire transfer, the Ponzi account had a balance of only $97,540. Later that same day, Drucker wired $635,000 from the Ponzi account to a bank account held by Weinstock. Thus, the wire transfer from the new $550,000 investor went not to purchase any financial instruments that might benefit the depositing investor, but instead within hours went straight into the account of Weinstock. Because of manipulations of this sort, the Ponzi account had a negative balance of $30 by the end of August, 1999.

Drucker also withdrew substantial funds from the Ponzi account to support lavish lifestyles for himself and others. During July, 1999, Drucker wrote checks from

the Ponzi account for $60,000 to an Atlanta hotel, $42,633 to purchase a Lexus automobile, $22,000 to purchase a Volkswagen, $10,900 to American Express, $6,971 to an Atlanta caterer, and $1,265 to the apartment complex where he purportedly lived at the time. Drucker's personal dipping into the account in August, 1999, was even more egregious. That month he wrote checks and wired funds out of the account totaling $1,875,000. The disbursements included more than $171,000 to American Express, $49,274 to purchase a BMW for himself, and $23,000 in checks that he issued to himself.

In essence, Drucker's day trading Ponzi scheme produced little or no profits through legitimate means, but instead obtained profits solely through the attraction of new investors in the scheme. Like all Ponzi schemes, the end result was the financial train wreck before the Court today. By the time the SEC was hot on Drucker's heels in September, 1999, approximately 80 investors had sunk $6.2 million into the fund. Three-fourths of these investors had lost money, a number of them losing sums in

excess of $100,000 and one of them losing $700,000. Weinstock and 17 other individuals, however, actually received returns in excess of their investments.

Plaintiff seeks to recover the money Weinstock received in excess of his investments. Plaintiff does not contend that Weinstock and the 17 other investors who financially benefitted from the Ponzi scheme have committed any fraud, only that they have been unjustly enriched at the expense of the numerous investors who lost money. Despite the positive financial returns received from all 18 of these investors, Weinstock is the only investor that Plaintiff has named as an Relief Defendant in this case.

According to Plaintiff, Weinstock entered into ten separate Management Agreements with Drucker for the purpose of investing in the stock market. Seven of the ten Management Agreements were between Drucker and Weinstock personally. Plaintiff alleges that the three remaining Management Agreements were for the benefit of Weinstock's three children. Weinstock responds that even though one of the Management Agreements is in his name, it actually was for the benefit of another investor not related to him. The Management Agreements varied markedly in both return on investment and duration of the agreements. A summary of the ten Management Agreements that Weinstock entered into with Drucker is as follows:

Agreement #	Date	Investment	Return	Duration
1	March 17, 1999	$100,000	$130,000	35 days
2	April 19, 1999	$130,000	$169,000	97 days
3	May 25, 1999	$369,000	Profits split evenly	Unlimited
4	June 1, 1999	$369,000	$469,000	60 days
5	August 25, 1999	$350,000	$525,000	14 days
6	August 25, 1999	$250,000	$500,000	60 days
7	August 25, 1999	$50,000	$100,000	60 days
8	August 25, 1999	$32,000	$64,000	60 days
9	August 25, 1999	$32,000	$64,000	60 days
10	August 25, 1999	$32,000	$64,000	60 days

The first two Management Agreements also provided that all capital gains taxes would be paid by Drucker.

In addition to his innocent participation in the Ponzi scheme, Weinstock also opened his own individual brokerage account with Fidelity in mid-March, 1999. Weinstock initially deposited $200,000 in the account and appointed Drucker as his agent to trade securities for the account. Acting as Weinstock's agent, on March 18, 1999, Drucker purchased 700 shares of Network Solutions, Inc. for $193,622.85.

Shortly thereafter, the company's stock split two-for-one, giving Weinstock a total of 1,400 shares. In April, 1999, Weinstock deposited another $169,000 into his Fidelity brokerage account and then himself purchased an additional 2,000 shares of Network Solutions stock. Over the next two months, the stock decreased in value. In early June 1999, Weinstock authorized the transfer of his brokerage account assets, which consisted primarily of 3,400 shares of Network Solutions, to the Ponzi account run by Drucker. According to the June 1, 1999, Management Agreement for that transfer, Weinstock was credited with a $369,000 investment into the Ponzi scheme, an investment approximately equal to Weinstock's basis in the brokerage account. While the SEC does not state what the value of the stock was exactly at the moment of transfer from Weinstock to the Ponzi scheme's account, later that same day Drucker sold the Network Solutions stock now in the Ponzi account for $201,915.76, or about $167,000 less than its original value when Weinstock purchased it. Plaintiff, therefore, contends that Weinstock was unjustly enriched by this brokerage account transfer in the amount of approximately $167,000.

Incidentally, Weinstock also served as Drucker's attorney in early contacts and meetings with Plaintiff. In early September, 1999, Weinstock notified Plaintiff's Atlanta office that he was representing Drucker in any action or inquiry Plaintiff was making. The next day, Weinstock received a $350,000 check from Drucker payable

to Weinstock. On September 10, 1999, Weinstock met with Plaintiff in its Atlanta office. In that meeting, Plaintiff explained to Weinstock that it was conducting a non-public investigation of Drucker to determine whether he had violated any federal securities laws. That same day, Weinstock received another check from Drucker, this one payable in the amount of $175,000. Three days later, on September 13, 1999, Weinstock again met with Plaintiff in its Atlanta office and reiterated that he was representing Drucker in Plaintiff's investigation.

Plaintiff has alleged that Weinstock invested $1,035,915.76 with Drucker and received returns totaling $1,575,514.05. Thus, Weinstock received a net financial benefit of approximately $539,000. It is this $539,000 benefit that Plaintiff has sought to recover from Weinstock. Plaintiff filed a Motion for Summary Judgment contending that no genuine issue of material fact exists and that it is entitled to recover the $539,000 as a matter of law. Weinstock responded that he is not required to return any of the benefit that he received from the Ponzi scheme and that, even if he is, Plaintiff has inaccurately calculated the benefit he actually received. According to Weinstock, the SEC has failed to give him full credit for the amount that he invested in the Ponzi scheme and has penalized him with receiving two payments from Drucker that were unrelated to the scheme. Consequently, Weinstock both contested Plaintiff's right to summary judgment and filed a Motion to Dismiss on grounds that Plaintiff's

Complaint sets forth no claim on which relief can be granted. While the Court was considering both Plaintiff and Weinstock's motions, Plaintiff and Weinstock informed the Court on August 29, 2000, that they had reached a proposed settlement.

On October 20, 1999, the Court entered a preliminary injunction enjoining Drucker from further operation of the Ponzi scheme. No Answer to the Complaint was filed by Drucker. In addition to its Motion for Summary Judgment against Weinstock, Plaintiff has filed a Motion for Default Judgment against Drucker. That motion remains before the Court. Drucker has not contested the motion. Weinstock, however, has contested the motion.

II. STANDARDS OF REVIEW

A complaint should be dismissed pursuant to Rule 12(b)(6) only where it appears beyond doubt that no set of facts could support the plaintiff's claims for relief. Fed. R. Civ. P. 12(b)(6); Conley v. Gibson, 355 U.S. 41, 47 (1957); Linder v. Portocarrero, 963 F.2d 332, 334 (11th Cir. 1992). In ruling on a motion to dismiss, the court must accept the facts pleaded in the complaint as true and construe them in the light most favorable to the plaintiff. Quality Foods de Centro Am., S.A. v. Latin Am. Agribusiness Dev. Corp., S.A., 711 F.2d 989, 994-95 (11th Cir. 1983). Notice pleading is all that is required for a valid complaint. Lombard's, Inc. v. Prince Mfg., Inc., 753 F.2d 974, 975 (11th Cir. 1985). Under notice pleading, the plaintiff need

only give the defendant fair notice of the plaintiff's claim and the grounds upon which it rests. Id.

Summary judgment is appropriate only when the pleadings, depositions, and affidavits submitted by the parties show that no genuine issue of material fact exists and that the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The court should view the evidence and any inferences that may be drawn in light most favorable to the nonmovant. Adickes v. S.H. Kress and Co., 398 U.S. 144, 158-159 (1970). The party seeking summary judgment must first identify grounds that show the absence of a genuine issue of material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 323-24 (1986). The burden then shifts to the nonmovant, who must go beyond the pleadings and present affirmative evidence to show that a genuine issue of material fact does exist. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 257 (1986).

When a party against whom a judgment for affirmative relief is sought fails to plead or otherwise defend as provided by the Federal Rules of Civil Procedure, the Clerk of Court shall enter the party's default if the default is sufficiently shown by affidavit or other competent proof. Fed. R. Civ. P. 55(a). If the Court determines the defendant is in default, the factual allegations of the complaint are taken as true, except those relating to the amount of damages. 10A Charles Alan Wright, Arthur R.

Miller & Mary Kay Kane, Federal Practice and Procedure § 2688 (1998). "Even after the default, however, it remains for the court to consider whether the unchallenged facts constitute a legitimate cause of action, since a party in default does not admit mere conclusions of law." Id.

III. DISCUSSION

A. MOTION TO DISMISS AND MOTION FOR SUMMARY JUDGMENT

Plaintiff has filed a Motion for Summary Judgment [Doc. 22] against Relief Defendant Weinstock to recover the $539,000 financial benefit Weinstock allegedly received from the Ponzi scheme. Weinstock has contested Plaintiff's motion and also has filed a Motion to Dismiss [Doc. 20] pursuant to Fed. R. Civ. P. 12(b)(6). Plaintiff and Weinstock, however, informed the Court on August 29, 2000, that they have reached a proposed settlement. Accordingly, both Plaintiff's Motion for Summary Judgment and Weinstock's Motion to Dismiss are denied without prejudice as moot. Should final settlement not be approved in this case, the parties may simply renew their pending summary judgment and dismissal motions by filing a one-page notice of renewal with the Court.

B. MOTION FOR ENTRY OF DEFAULT JUDGMENT

Plaintiff has filed a Motion for Entry of a Default Judgment [Doc. 48] against Defendant Drucker. Plaintiff contends that it is entitled to a default judgment because

Drucker has failed to respond to this lawsuit. Drucker was personally served on October 15, 1999, with a summons and copy of the Complaint in this action. Drucker failed to answer or otherwise respond to the Complaint, and the Clerk of this Court entered a default judgment against Drucker at the request of Plaintiff. Drucker has failed to respond to Plaintiff's Motion for Entry of a Default Judgment. Consequently, Plaintiff requests that this Court: enter a default judgment that enjoins Drucker from committing future violations of federal securities laws that he allegedly violated; order Drucker to disgorge the $1,991,659.84 in ill-gotten gains and prejudgment interest that allegedly constitutes personal profit to him; and levy a civil penalty against him in the amount of $110,000.

Although Drucker has not responded to Plaintiff's Motion for a Default Judgment, Relief Defendant Weinstock has filed a Brief in Opposition to Plaintiff's Motion [Doc. 49] arguing that the amount Plaintiff seeks from Drucker is too little and does not adequately compensate the defrauded investors for all of their losses. Weinstock contends that the amount Plaintiff seeks from Drucker is limited to Drucker's personal profit and that Plaintiff instead should be seeking to recover from Drucker the total amount of loss suffered by the victims of the Ponzi scheme. Weinstock argues that SEC v. Better Life Club of America, Inc., 995 F. Supp. 167, 179 (D.D.C. 1998), aff'd, 203 F.3d 54 (D.C. Cir. 1999), requires Plaintiff to seek both

the personal profit Drucker received and the amount of loss that the defrauded investors suffered. This interpretation of Better Life Club, however, is without merit. Better Life Club simply holds that Plaintiff *may* seek the defrauder's profit through disgorgement and attempt to recover the investors' losses through restitution. The case does not mandate that Plaintiff must do both. Indeed, the Court in Better Life Club specifically emphasized that federal courts have "broad discretion" in how to fashion equitable remedies. Id.

The Court refuses to encroach upon Plaintiff's prosecutorial and enforcement discretion. "[A]n agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion." Heckler v. Chaney, 470 U.S. 821, 831 (1985). Weinstock contends that Plaintiff " [f]or some unexplained reason . . . has elected to undercut its own broad authority as laid out under [Better Life Club] and, instead, seeks only disgorgement from Drucker." (Relief Def. Michael Weinstock's Br. in Opp. To Pl.'s Mot. for Entry of Default J. Against Def. Mark Drucker, at 4.) [Doc. 49] This argument, however, ignores the fact that Plaintiff may have numerous reasons for seeking only the amount from Drucker it does but not any additional recovery. As the Supreme Court has explained:

> [A]n agency decision not to enforce often involves a complicated balancing of a number of factors which are peculiarly within its expertise. Thus, the agency must not only assess whether a violation has occurred, but whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it acts, whether the particular enforcement action best fits the agency's overall policies, and, indeed, whether the agency has enough resources to undertake the action at all . . . . The agency is far better equipped than the courts to deal with the many variables involved in the proper ordering of its priorities.

Heckler, 470 U.S. at 831-32.

In this case, Drucker has not responded to Plaintiff's motion. Perhaps Drucker agreed not to challenge the default judgment motion if Plaintiff did not seek additional recovery from Drucker. If Plaintiff did seek additional recovery, perhaps it feared Drucker would more strenuously challenge the amount of damages, forcing Plaintiff to expend valuable resources that it feels are more appropriately directed elsewhere. Perhaps Plaintiff has learned through its investigation that actual recovery of the additional amounts would be almost impossible or at least quite difficult regardless of whether it has obtained a judgment to recover them. Whatever the reasons, it is not for the Court to second guess Plaintiff's decision to seek less recovery from Drucker than it could have. As Weinstock argues, perhaps "the relief sought against Drucker for his multiple violations of federal securities laws raises the question of the SEC's *strategy* in this litigation." (Relief Def. Michael Weinstock's Br. in Opp. To Pl.'s

Mot. for Entry of Default J. Against Def. Mark Drucker, at 6 (emphasis added).) [Doc. 49] Such strategic decisions, however, are within Plaintiff's prosecutorial and enforcement discretion. It would be improper for the Court to encroach upon that discretion.

Weinstock also contends that Plaintiff's Motion for Entry of Default Judgment is unjust and unfair to Weinstock because Plaintiff fails to seek the full amount of relief from the wrongdoer Drucker before it seeks relief from Weinstock. As Weinstock sees it, "[t]he SEC continues to attempt to place the financial burden of Drucker's fraud on a single, unwitting, profitable investor – Relief Defendant Weinstock – at the expense of the losing investors on whose behalf the SEC claims to be acting." (Relief Def. Michael Weinstock's Br. in Opp. To Pl.'s Mot. for Entry of Default J. Against Def. Mark Drucker, at 7.) [Doc. 49] This contention raises numerous issues that Weinstock asserted in his Motion to Dismiss and opposition to Plaintiff's Motion for Summary Judgment. Accordingly, the Court deals with the two challenges asserted in those motions that Weinstock has resurrected here.

First, Weinstock contends that he is responsible for repayment of his profit only if Drucker is financially unable to pay the losing investors the full amount of their losses. (Relief Def. Michael Weinstock's Br. in Opp. To Pl.'s Mot. for Entry of Default J. Against Def. Mark Drucker, at 7.) [Doc. 49] In making this argument,

Weinstock cites the Court to his Motion to Dismiss [Doc. 20] and Brief in Opposition to Plaintiff's Motion for Summary Judgment [Doc. 44]. Where a securities law violator transfers fraudulently obtained proceeds to a third party, federal courts are empowered to exercise traditional equitable remedies to recover the proceeds, even if the third party is not alleged to have violated any securities laws. SEC v. Better Life Club of Am., Inc., 995 F. Supp. 167, 181 (D.D.C. 1998); SEC v. Infinity Group Co., 993 F. Supp. 324, 331 (E.D. Pa. 1998); SEC v. Antar, 831 F. Supp. 380, 398-401 (D.N.J. 1993); SEC v. Glauberman, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,909 at 93,760-61 (S.D.N.Y. July 16, 1992). One means by which a court may accomplish this recovery is through a constructive trust. E.g., Rollins v. Metropolitan Life Ins. Co., 912 F.2d 911, 914 (7th Cir. 1990); SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir. 1971); United States v. Cannistraro, 694 F. Supp. 62, 72 n.11 (D.N.J. 1988), aff'd in part and vacated in part on other grounds, 871 F.2d 1210, 1217 (3d Cir. 1989). A constructive trust is a judicially created device by which a court may collect proceeds from those who have been unjustly enriched to protect the equitable rights of those who have been victimized. See Restatement (Second) of Trusts, § 1 cmt. e (1959) ("A constructive trust is a relationship with respect to property subjecting the person by whom the title to the property is held to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he

were permitted to retain the property."); see also Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (1919) (Cardozo, J.) ("A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.").

A constructive trust may be used even in cases where the person or entity unjustly enriched is wholly innocent of any wrongdoing. SEC v. Colello, 139 F. 3d 674, 676 (9th Cir. 1998); Rollins v. Metropolitan Life Ins. Co., 912 F.2d 911, 914 (7th Cir. 1990); SEC v. Better Life Club of Am. Inc., 995 F. Supp. 167, 180-84 (D.D.C. 1998); SEC v. Infinity Group Co., 993 F. Supp. 324, 331 (E.D. Pa. 1998); see also CFTC v. Hanover Trading Corp., 34 F. Supp.2d 203, 207 (S.D.N.Y. 1999) ("Subsequent cases have extended Deckert to permit recovery from relief defendants, irrespective of their culpability, who possess illegally obtained profits and have no legitimate claim to them."). It is not even necessary that the person holding the property was a party to the pertinent transaction. E.g., Deckert v. Independence Shares Corp., 311 U.S. 282, 284-85 (1940); SEC v. Antar, 831 F. Supp. 380, 382, 402 (D.N.J. 1993). The question is simply whether the enriched person or entity has a legitimate claim to the property. See SEC v. Cherif, 933 F.2d 403, 414 n.11 ("A court can obtain equitable relief from a non-party against whom no wrongdoing is alleged

if it is established that the non-party possesses illegally obtained profits but has no legitimate claim to them.").

The policy underlying these equitable principles is that beneficiaries of fraud should not be allowed to walk away with gains at the expense of the fraud's victims. See, e.g., Antar, 831 F. Supp. at 403 ("As between the nominal defendants and the victims of fraud, equity dictates that the rights of the victims should control."). This would seem especially so where the fraud perpetrated is a Ponzi scheme since an investor's status as a beneficiary or victim in such a scheme usually depends only on the point in time when he invested. See In re Independent Clearing House Co., 77 B.R. 843, 870 (D. Utah 1987) ("The fortuity that these defendants got into the scheme early enough to make a profit should not entitle them to a reward at the expense of equally innocent undertakers who entered the scheme later . . ."). A court should thus use its power to restore the investors to their original position of "no-gain, no-loss" as much as possible.

Relief Defendant Weinstock does not challenge the Court's general power to allow recovery against unjustly enriched relief defendants who have benefitted from a Ponzi scheme. Contributions to a Ponzi scheme do not constitute value given sufficient to create a legitimate claim to profits earned. Missal v. Washington, 1998 U.S. Dist. LEXIS 6016, at *10 (D.D.C. Apr. 17, 1998); In re International Loan

Network, Inc., 160 B.R. 1, 16 (Bankr. D.D.C. 1993). Weinstock only contends that Plaintiff must seek full and complete relief from Drucker before it can seek relief from Weinstock. According to Weinstock, the "well-spring" case regarding recovery from a relief defendant is the 1940 United States Supreme Court case Deckert v. Independence Shares Corporation, 311 U.S. 282, 284 (1940). Weinstock says that Deckert limits restitution against a third party to only those cases where the principal defendant is insolvent. Because Plaintiff has not alleged that Drucker is insolvent, Weinstock contends that Plaintiff must seek relief from Drucker before targeting Weinstock. Plaintiff admits that the principal defendant inDeckert was insolvent but disagrees that the Supreme Court limited its holding to cases where the principal defendant is insolvent. Plaintiff contends thatDeckert instead stands for the broader principle that a plaintiff may obtain restitution from a third party whenever that party lacks a legitimate claim to profits and thus has unjustly profited at another's expense. To support this argument, Plaintiff cites three reported cases where federal courts have granted the SEC equitable relief against unjustly enriched third parties even though the principal defendant was not alleged insolvent. SEC v. Cavanaugh, 155 F.3d 129, 131 (2d Cir. 1998); SEC v. Colello, 139 F.3d 674, 675 (9th Cir. 1998); andSEC v. Infinity Group Co., 993 F. Supp. 324, 331 (E.D. Pa. 1998).

In Deckert, the plaintiffs were owners and holders of contract certificates purchased from a predecessor of Defendant Independence Shares Corporation. The plaintiffs filed suit against Independence for fraudulent misrepresentation and concealment prohibited by the Securities Act of 1933. The plaintiffs realized that Independence was insolvent and threatened with many other lawsuits. Consequently, they also sought recovery from a second company, The Pennsylvania Company for Insurances on Lives and Granting Annuities, which collected dividends and profits for Independence and administered a trust for it using the plaintiffs' funds. The trial judge appointed a master to report to him regarding Independence's insolvency but specifically reserved judgment on whether to appoint a receiver. Despite the fact that he did not appoint a receiver, the trial judge enjoined Pennsylvania from transferring the $38,258.85 it held in the Independence trust. On appeal, the Third Circuit Court of Appeals reversed, concluding that the Securities Act of 1933 does not authorize a plaintiff to seek equitable relief against a third party who possesses assets that the wrongdoing defendant fraudulently acquired. After granting *certiorari*, the Supreme Court reversed the Third Circuit, holding that the plaintiffs could sue in equity to rescind the fraudulent sale between them and Independence and to secure restitution from Pennsylvania.

Weinstock's interpretation of this case rests heavily on the Supreme Court's characterization of the questions presented on appeal in Deckert. One of the questions presented was whether purchasers of securities can maintain a suit in equity against a third party "where the vendor is insolvent and the third party has assets in its possession belonging to the vendor." Deckert, 311 U.S. at 284. The issue here is whether the clause "where the vendor is insolvent" simply recites the particular factual circumstances of the case or instead constitutes a limit on the Court's holding. Weinstock emphasizes the following language from Deckert:

> We are of opinion that the bill states a cause for equitable relief. There are allegations that Independence is insolvent, that its business is practically halted, that it is threatened with many lawsuits, that its assets are endangered, and that preferences to creditors are probable. There are prayers for an accounting, appointment of a receiver, an injunction pendente lite, and for return of petitioners' payments. Other allegations show that although petitioners dealt with Independence their installments were paid to Pennsylvania and that the complicated arrangement between Pennsylvania and Independence might make it extremely difficult to obtain satisfaction of any claim established against Independence.

Deckert, 311 U.S. at 288-89.

The Supreme Court's recitation of facts surrounding Independence's insolvency does not mean that equitable relief may be asserted against a third party only in cases where the principal defendant is insolvent. A close reading of the case, especially in

context of the language immediately following the above quote, shows that the Supreme Court was not considering only the appropriateness of equitable relief against Pennsylvania, but also whether appointing a receiver for Independence and allowing rescission of the contracts was proper. See id. at 289. ("That a suit to rescind a contract induced by fraud and to recover the consideration paid may be maintained in equity, at least where there are circumstances making the legal remedy inadequate, is well established."). Independence's insolvency was much more relevant to those issues. Thus, while Deckert discusses both Independence's insolvency and whether to allow equitable relief against Pennsylvania, nothing in the opinion precludes equitable relief against a third party where the wrongdoer is solvent.

As additional support for the Court's conclusion, it notes that Deckert has been extended by subsequent federal cases to allow equitable relief against third parties even when the wrongdoer is solvent. Conversely, no federal court since Deckert has explicitly limited recovery from a relief defendant to those cases where the wrongdoer is insolvent. At least three circuits and district courts in another two circuits have allowed recovery against relief defendants in securities cases where no inference exists that the principal defendant was insolvent. SEC v. Cavanaugh, 155 F.3d 129, 131 (2d Cir. 1998); SEC v. Colello, 139 F.3d 674, 675 (9th Cir. 1998); Scholes v. Lehmann, 56 F.3d 750, 753 (7th Cir. 1995); SEC v. Better Life Club of Am., Inc., 995 F. Supp.

167, 171 (D.D.C. 1998); SEC v. Infinity Group Co., 993 F. Supp. 324, 331 (E.D. Pa. 1998). "As to relief defendants, it is axiomatic that [a court] may impose equitable relief on a third party against whom no wrongdoing is alleged if it is established that the third party possesses illegally-obtained profits but has no legitimate claim to them." SEC v. Infinity Group Co., 993 F. Supp. at 331. The plaintiff need only establish that the relief defendant was enriched and that "the circumstances dictate that, in equity and good conscience, the defendant should be required to turn over its money to the plaintiff." SEC v. Antar, 831 F. Supp. 380, 403 (D.N.J. 1993). In light of Deckert and its progeny, this Court concludes that a plaintiff need not also show that the principal defendant is insolvent in order to seek restitution from a relief defendant.

Second, Weinstock contends that the Due Process Clause of the Fifth Amendment requires that Plaintiff must attempt to obtain full relief from Drucker in the total amount of his fraud before it can ever seek restitution from Weinstock. As Weinstock sees it, Plaintiff has not provided him with sufficient notice of what conduct would result in an enforcement action. "Due process requires that 'laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited.'" Upton v. SEC, 75 F.3d 92, 98 (2d Cir. 1996) (quoting Graynard v. City of Rockford, 408 U.S. 104, 108 (1972)). Weinstock contends that Plaintiff's use of

the equitable theory of unjust enrichment violates due process because Plaintiff has failed to adopt this theory as a rule or statement of policy that would receive wider public attention. To support this argument Weinstock relies on a footnote in Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1294 n. 13 (2d Cir. 1973), in which the Second Circuit admonished the SEC that "for the future the [SEC] should proceed by a rule or statement of policy that would receive wider public attention." Id. Weinstock also cites Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994), the seminal Supreme Court case on aider and abettor securities liability in which the Court emphasized that the text of Section 10(b) of the Securities Exchange Act of 1934 does not support a cause of action against aiders and abettors of securities fraud. Id.

It is true that Central Bank stands for the proposition that causes of action under the securities laws must have a basis in the text of the statute. It is also true that the federal securities laws do not explicitly mention the use of relief defendants. Nevertheless, there is ample, long-standing law, including Supreme Court precedent, that supports the naming of relief defendants in securities enforcement actions to recover the proceeds of fraud. "For example, the Supreme Court has held that a plaintiff who has a cause of action under the securities laws can enforce those rights 'by such legal or equitable actions or procedures as would normally be available to

him.'" SEC v. Colello, 139 F.3d 674, 676 (9th Cir. 1998) (citing Deckert v. Independence Shares Corp., 311 U.S. 282, 287-88 (1940)). Additionally, "in other contexts the Supreme Court has upheld the power of the Government without specific statutory authority to seek restitution, and has upheld the lower courts in granting restitution, as an ancillary remedy in the exercise of the courts' general equity powers to afford complete relief." SEC v. Texas Sulphur Co., 446 F.2d 1301, 1307 (2d Cir. 1971) (citing Mitchell v. Robert DeMario Jewelry, Inc., 361 U.S. 288, 291 (1960), United States v. Moore, 340 U.S. 616, 620 (1951), and Porter v. Warner Holding Co., 328 U.S. 395, 398 (1946)). The Supreme Court strongly reaffirmed federal courts' exercise of these equitable powers as recently as 1992. See Franklin v. Gwinnett County Public Schools, 503 U.S. 60, 68-71 (1992) (upholding district court's imposition of an equitable remedy so long as it is presented with a violation of a federal statute).

Furthermore, the Ninth Circuit has explained the Central Bank decision by emphasizing that "[t]he Supreme Court's hostility to causes of action without textual support and precedent supporting broad equitable powers can be reconciled by distinguishing between *causes of action* and *forms of relief*, a distinction drawn by the Supreme Court." Colello, 139 F. 3d at 676 (emphasis added); see also SEC v. Sands, 902 F. Supp. 1149, 1158 (C.D. Cal. 1995) ("The Central Bank decision does not

'renounce[] the once predominant view that courts may invoke whatever rights and remedies they deem appropriate to effectuate the purposes of the securities laws.'" (Citation omitted.)). The Court finds this distinction persuasive. Central Bank involves whether a cause of action exists against aiders and abettors. In contrast, this case involves whether restitution is an available form of relief. Moreover, as one federal district court has observed:

> In SEC enforcement actions, the courts have provided varied forms of equitable relief – including disgorgement, asset freezes, appointments of receivers and repatriation – even though the jurisdictional sections of the securities statutes refer only to injunctions against violations. A constructive trust and disgorgement of unjustly retained wealth – the relief sought against the nominal defendants – are long-standing remedies that are within a court's equity powers.

SEC v. Antar, 831 F. Supp. 380, 398 (D.N.J. 1993). Given that restitution from relief defendants is a long-standing remedy that federal courts often have employed and that its practice has been upheld by the Supreme Court repeatedly, this Court cannot conclude that Weinstock was not sufficiently on notice that the SEC could recover the profits he received from the Ponzi scheme.

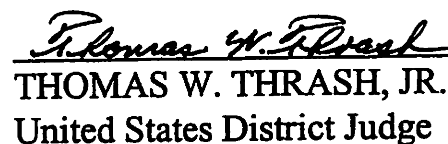
For the reasons set forth above the Court concludes that Weinstock's challenges to Plaintiff's Motion for Entry of a Default Judgment are without legal merit. Because Drucker has wholly failed to respond to the claims asserted against him in this action,

including Plaintiff's Motion for Entry of a Default Judgment, the Court concludes that a hearing on damages is not warranted in this case. See 10A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, Federal Practice and Procedure § 2688 (1998) (stating that a full hearing may be required on the amount of damages only when the defendant contests the amount of the claim). The Court grants Plaintiff's motion. The judgment will be entered in a separate order.

IV. CONCLUSION

For the reasons set forth above, Relief Defendant Michael Weinstock's Motion to Dismiss [Doc. 20] is DENIED WITHOUT PREJUDICE AS MOOT, Plaintiff's Motion for Summary Judgment [Doc. 22] is DENIED WITHOUT PREJUDICE AS MOOT. Plaintiff's Motion for Entry of Default Judgment Against Defendant Michael Drucker [Doc.48] is GRANTED. Judgment in accordance with this Order is ENTERED in favor of Plaintiff against Defendant Drucker.

SO ORDERED, this 13 day of September, 2000.



THOMAS W. THRASH, JR.
United States District Judge