

3-27

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

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff

v.

FUNDING RESOURCE GROUP,
a/k/a FRG TRUST, et al,

Defendants

and

HOWE FINANCIAL TRUST, et al,

Equitable Relief Defendants

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CIVIL ACTION NO.
3:98-CV-2689-X

BRIEF IN SUPPORT OF MOTION TO DISSOLVE ORDER FREEZING ACCOUNT

COMES NOW Jerrold L. Gunn, an interested party herein, and files this his Brief in Support of Motion to Dissolve Order Freezing Account and would respectfully show this Court as follows:

I.

INTRODUCTION

1. On November 29, 1999, this Honorable Court entered its Order Freezing Account, which froze Merrill Lynch Account No. 75023822 in the name of Jerrold L. Gunn. The Order Freezing Account was based on the Receiver's Emergency *Ex Parte* Application to Freeze Account and Brief in Support thereof (the "Application"), which contained vague and

conclusory allegations that Jerrold Gunn wrongfully received tainted investor funds and was somehow a party to fraud. In reality all of the subject funds received by Jerrold Gunn were the payments for consulting fees which he earned.

2. The Application and the Order Freezing Account are part of a wide spread and ever-increasing proceeding brought by the SEC based on an alleged "ponzi scheme" in which Jerrold Gunn had no involvement and from which Jerrold Gunn received no profits. By this motion, Jerrold Gunn requests this Court dissolve the Order Freezing Account in its entirety.

II.

FACTUAL BACKGROUND

A. The Parties

1. The Plaintiff

3. This action is brought by the Securities and Exchange Commission (the "SEC"), alleging a "ponzi scheme" arising from the sale of certain "prime bank" securities. Michael J. Quilling, Esq. (the "Receiver") has been appointed receiver over the assets of the defendants in this action.

2. The Primary Defendants

4. The SEC alleges that certain individuals and entities participated in the alleged "ponzi scheme", defrauding investors out of approximately \$14 million through the sale of the "prime bank" securities. These entities and individuals are: Funding Resource Group, Quentin Hix, Gene Coulter, Steven C. Roberts, MVP Network, Inc., FMCI Trust, Funders Marketing Company, Inc., Raymond G. Parr, Willard Veal Smith, Earl D. McKinney, Fortune

Investments, Ltd., Robert Cord, Winterhawk West Indies, Ltd., IGW Trust, Carolyn Don Hicks and Carl Weaver (hereinafter referred to as the "Primary Defendants").

3. The Relief Defendants

5. Additionally, the SEC has sued certain individuals and entities alleging that they have "obtained a portion of the monies which [the Primary Defendants] had obtained from investors for themselves."¹ These entities and individuals are: Howe Financial Trust, TREDIS Financial Trust, Mary Ann Bauce, Hammersmith Trust, L.L.C. (Tennessee), Hammersmith Trust, L.L.C. (Nevis, West Indies), Hammersmith Trust, Ltd., Bridgeport Alliance, L.L.C., Landfair Custodial Services, Inc., Microfund, L.L.C., American Pacific Bank & Trust, Inc., Eurofund Investment, Inc., B. David Gilliland and Melody Rose (hereinafter referred to as the "Relief Defendants").

4. Other Non-Parties

6. In this Court's Order Freezing Assets, Reinstating Appointment of Receiver and Authorizing Expedited Discovery signed July 22, 1999, this Court entered injunctive relief against the following parties: Economic Development Corporation, Concorde International Holding Corp., Continental Management Group, Inc., Primary Services, Inc., Seven Dials Aviation Corp., William H. West, David M. Bishara, Kenneth B. Cobb and Raymond J. Hanson, based on the find that Relief Defendant Hammersmith Trust, L.L.C. "has transferred other assets" to such individuals and entities.² Although this Court's order does not address

¹ Third Amended Complaint, pages 2 and 3.

² Order Freezing Assets, Reinstating Appointment of Receiver and Authorizing Expedited Discovery, signed July 22, 1999, pages 2 and 3.

the basis of its jurisdiction basis over these nonparties; presumably, these entities are “nominal parties,” which can be joined without an assertion of subject matter jurisdiction.

5. Jerrold Gunn

7. Jerrold Gunn is not a party to this action – as either a Primary Defendant or a Relief Defendant. Jerrold Gunn would presume that the Receiver would contend that he is a “nominal defendant.”

B. The Allegations

8. The latest version of the Complaint by the SEC is the Third Amended Complaint filed on or about July 28, 1999. In such pleading, the SEC asserts the following five causes of action:

- A. The Primary Defendants violated Section 10(b) and Rule 10b-5;³
- B. The Primary Defendants violated Section 17(a)(1);⁴
- C. The Primary Defendants violated Section 17(a)(2)-(3);⁵
- D. The Primary Defendants violated Section 5(a) and (c);⁶ and
- E. The Relief Defendants should be required to disgorge all funds received which are traceable to the unlawful activities of the Primary Defendants.⁷

³ Third Amended Complaint, pages 23-24.

⁴ Third Amended Complaint, pages 24-25.

⁵ Third Amended Complaint, pages 25-26.

⁶ Third Amended Complaint, pages 26-27.

⁷ Third Amended Complaint, pages 27-28.

9. Thus, the **only** claim made against the Relief Defendants is for disgorgement.

C. The Non-Existent "Money Trail."

10. The SEC alleges that the Primary Defendants raised more than \$14 million under their scheme to sell "prime bank" securities.⁸ The SEC further alleges that Relief Defendant Howe Financial Trust received "no less than \$600,000" to Relief Defendant Hammersmith, L.L.C.⁹ The SEC then curiously alleges that "Howe, in turn, transferred \$2.745 million to Hammersmith Trust, L.L.C."¹⁰ and that Hammersmith Trust, L.L.C. owes millions of dollars to Howe."¹¹ No mention is made regarding whether the SEC alleges that the \$600,000 of investor funds received by Howe has been traced to Hammersmith Trust, L.L.C., and whether Hammersmith Trust, L.L.C. has ever held tainted funds.

11. It would appear that more than \$600,000 was paid to the Receiver by one or

⁸ Third Amended Complaint, page 2.

⁹ Emergency Motion to Freeze Assets, for Reinstatement of Appointment of Receiver and for Expedited Discovery, page 9.

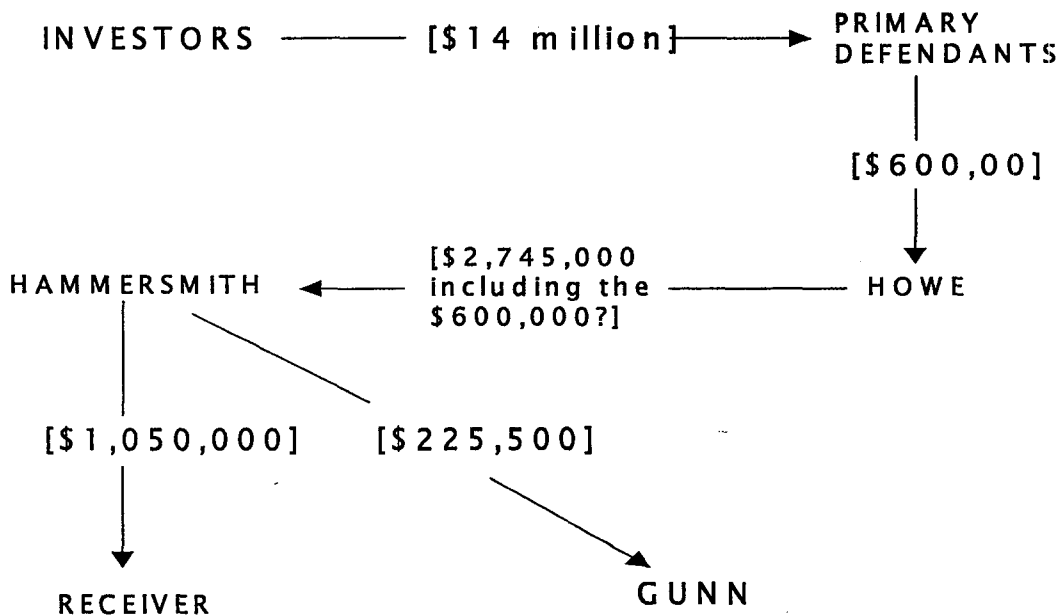
¹⁰ For purposes of convenience in this Motion only, Jerrold Gunn adopts the definition of "Hammersmith Trust, L.L.C." used by this Court in its Order Freezing Assets, Reinstating Appointment of Receiver and Authorizing Expedited Discovery, signed July 22, 1999, pages 2: "Hammersmith Trust, L.L.C., when referred to herein, refers to any and all Hammersmith Trust, L.L.C. entities, including but not limited to the Tennessee entity and the Nevis, West Indies entity." Order Freezing Assets, Reinstating Appointment of Receiver and Authorizing Expedited Discovery, signed July 22, 1999, pages 2

¹¹ Emergency Motion to Freeze Assets, for Reinstatement of Appointment of Receiver and for Expedited Discovery, page 9. The \$2,745,000 figure would appear to be the total amount of transactions between Howe and Hammersmith, of which the allegedly tainted \$600,000 would be but a portion.

more entities related to Hammersmith Trust, L.L.C.¹²

12. In the Application, the Receiver states to this Court, under oath, that “the Receiver has been able to trace at least \$225,500 to Jerrold Gunn.”¹³ However, the Application appears purposefully vague as to whether the \$225,500 constitutes tainted funds arising from the sale of the “prime bank” securities.

13. Thus, the “money trail” can be illustrated as follows:



¹² In its Emergency Motion to Freeze Assets, for Reinstatement of Appointment of Receiver and for Expedited Discovery, the SEC references an agreed order by which certain parties agreed to pay the Receiver \$2,745,000 and later suggests that \$1,695,000 remained owing. (Pages 3 and 4.)

¹³ Application, page 2.

III.

ARGUMENT

14. Jerrold Gunn is not a party to this action. Typically, a court is not authorized to freeze the assets of a non-party against whom no wrongdoing is alleged. *Securities and Exchange Commission v. Cherif*, 933 F.2d 403, 413-414 (7th Cir. 1991), *cert. denied*, 502 U.S. 1071, 112 S.Ct. 966, 117 L.Ed.2d 131 (1992) (discussing 15 U.S.C. §78u). However, “[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.” *Securities and Exchange Commission v. Cherif*, 933 F.2d at 414 (fn 11.) Such a party is known as a “nominal defendant.” *Securities and Exchange Commission v. Cherif*, 933 F.2d at 414. Although the Receiver made vague and conclusory allegations of wrongdoing against Jerrold Gunn, nothing has been “established.” Accordingly, Jerrold Gunn requests this Court dissolve the Order Freezing Account, unless the Receiver is able to **establish** his allegations.

15. Moreover, the Receiver utterly fails to explain the legal basis of any liability asserted against Jerrold Gunn. Presumably, any such liability would be based on the equitable remedy of disgorgement. However, “[t]he purpose of disgorgement is not to compensate the victims of the fraud, but to deprive the wrongdoer of his ill-gotten gain.” *Securities and Exchange Commission v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978). Moreover, “[d]isgorgement is remedial and not punitive. The court’s power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing.”

Securities and Exchange Commission v. Blatt, 583 F.2d at 1335.

16. As described above, the SEC alleges that only \$600,000 of the “ill-gotten gain” from the sale of the “prime bank” securities reached Hammersmith Trust, L.L.C. Moreover, as described above, it would appear that Hammersmith Trust, L.L.C. or related entities paid more than such amount to the Receiver. The fact that such payment was made pursuant to an agreed order does not affect this legal analysis, because Jerrold Gunn was not a party to such agreed order. Thus, no “ill-gotten” gain from the sale of the “prime bank” securities can possibly remain with Hammersmith Trust, L.L.C., and thus existing law provides no basis for any recovery against Jerrold Gunn.

IV.

CONCLUSION

17. Jerrold Gunn did not receive tainted funds and did not participate in the sale of the “prime bank” securities; rather, Jerrold Gunn was paid the funds in question as legitimate consulting fees. Accordingly, the Order Freezing Account should be immediately dissolved unless the Receiver, after an evidentiary hearing, can establish a solid basis for his accusations. Moreover, as a matter of law, recovery is not permitted against Jerrold Gunn, since Hammersmith Trust, L.L.C. has already paid to the Receiver an amount in excess of the amount of tainted funds which the SEC alleges it received.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing has been forwarded via First Class U.S. Mail (unless otherwise indicated) requested on this the 27 day of March, 2000, pursuant to the Federal Rules of Civil Procedure to those parties listed below:

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