ORIGINAL

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. FREDERICK J. GILLILAND, Defendant, and MM ACMC BANQUE DE COMMERCE, INC., Relief Defendant.	CIVIL ACTION FILE NO. 3:02CV128-~~H~~

PLAINTIFF'S MOTION FOR DEFAULT JUDGMENT AGAINST DEFENDANT FREDERICK GILLILAND

The plaintiff, Securities and Exchange Commission ("Commission" or the "Plaintiff"), files this motion for default judgment, disgorgement, prejudgment interest and civil penalties against the defendant, Frederick J. Gilliland ("Gilliland"). As grounds for this motion, the Commission states that Gilliland was served with the summons and complaint in this matter on June 12, 2002 and that Gilliland has not filed any answer or other responsive pleading. Thus, this Court should enter a default judgment pursuant Rule 55(b)(2) of the Federal Rules of Civil Procedure. In further support of this motion, the Commission respectfully refers the Court to the Commission's supporting brief and exhibits, filed concurrently herewith.

WHEREFORE this Court should enter default judgment against Gilliland in the form filed concurrently herewith (1) permanently enjoining Gilliland from violating Sections 5(a), 5(c)

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and 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; (2) ordering disgorgement of $9.4 million and prejudgment interest of $635,179; and (3) imposing civil penalties in an amount determined by this Court.

Respectfully submitted this 3rd day of June, 2003.

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CERTIFICATE OF SERVICE

I, M. Graham Loomis, certify that I have served the foregoing SECURITIES AND EXCHANGE COMMISSION'S MOTION FOR DEFAULT JUDGMENT on the Defendant and Relief Defendant by US Mail, postage prepaid, addressed as follows:

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This 13th day of June, 2003

M. Graham Loomis

ORIGINAL

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. FREDERICK J. GILLILAND, Defendant, and MM ACMC BANQUE DE COMMERCE, INC., Relief Defendant.	CIVIL ACTION FILE NO. 3:02CV128-McK

PLAINTIFF'S BRIEF IN SUPPORT OF ITS MOTION FOR DEFAULT JUDGMENT AGAINST DEFENDANT FREDERICK GILLILAND

The plaintiff, Securities and Exchange Commission ("Commission" or the "Plaintiff"), files this brief in support of its motion for default judgment against defendant Frederick J. Gilliland ("Gilliland") as follows:

I. SUMMARY

Between at least mid-1997 through November 1998, Frederick Gilliland sold more than $29 million in interests in a succession of non-existent prime bank trading programs to more than 200 investors. In connection with his scheme, Gilliland misrepresented and omitted material facts concerning: (1) the existence of the trading programs; (2) the use of investor funds; (3) the promised return; and (4) the safety of the funds invested. Gilliland persuaded his investors to

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wire funds to at least four offshore bank accounts that he had established in the Isle of Mann, Bermuda and the Caribbean.

The Commission instituted this proceeding on March 27, 2002 and served with the complaint and summons on June 12, 2002. Because Gilliland failed to file any answer or any other responsive pleading, the Commission obtained an for Entry of Default against Gilliland on August 5, 2002. The Commission now seeks a default judgment, imposing disgorgement of $9.4 million and $635,179 in prejudgment interest, plus civil penalties in an amount to be determined by this Court. See June 14, 2003 Declaration of Michael J. Quilling at ¶¶ 6-7.[1]

II. FACTS

A. Gilliland's Prime Bank Scheme

Gilliland collected in excess of $29 million from over 200 investors throughout the United States, Canada, and the United Kingdom, telling investors that they were investing in bank debenture or high-yield trading programs, which in fact did not exist. (Complaint ¶ 1; June 14 Quilling Decl. at ¶ 4). The investment agreements that investors typically signed referred to the investment programs as a "high-yield banking transaction."[2] Most of these programs guaranteed high rates of return ranging from 30% per month to as high as 130% per 10 days, depending on the amount of investment.[3] Moreover, the investment agreements stated that: (1) the investor's funds would be pooled with other monies provided by Sterling Management

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[1] The June 14, 2003 Declaration of Michael J. Quilling ("June 14 Quilling Decl.") is attached hereto as Exhibit 1.

[2] See, e.g., Appendix 1 to Affidavit of Paul Smith. (The Smith Affidavit is attached hereto as Exhibit 2).

[3] See, e.g., Affidavit of Rex Weller at ¶ 4 (Gililland promised payments of 60% of the principal per month) (attached hereto as Exhibit 3); P. Smith Aff. at ¶ 3; Appendix 2 to Rosie Fan Affidavit. (promising returns of 50% for 12 months) (The Fan Affidavit is attached hereto as Exhibit 4).

Services, Inc. ("Sterling Management") in order to meet the minimum amount necessary to participate in the investment; (2) the principal investment would be fully collateralized by U.S. Treasury bills; (3) there was no risk to the principal; and (4) the full principal would be returned to the investor at the termination of the agreement.[4] Gilliland knew that these representations were false. (Complaint at ¶ 78).

Gilliland promoted these investment programs to potential investors by live presentations he conducted, written materials and by word-of-mouth. Gilliland also provided some investors with a handout that described the purported history of bank debenture programs and the exclusivity of these opportunities. (Complaint at ¶ 21). The handout assured investors that only the world's "most powerful and stable Money Centre Banks take part in" the investment program offered by Gilliland and that the program was regulated by "the 100-year-old, worldwide regulatory body for the international banking community, the international Chamber of Commerce in Paris." (Complaint at ¶ 23). Gilliland also told some investors that he had invested in the program and earned substantial profits. (Complaint at ¶¶ 43, 63). Gilliland knew that all of these representations were false. Gilliland also told some investors that he was retaining a percentage of their profits from their investments in the trading programs. (Declaration of Laura Nishimura at ¶ 10).[5]

During all relevant times, Gilliland was not registered with the Commission as a broker or dealer or a registered representative of a broker or dealer. (Complaint at ¶ 103). Gilliland also never filed a registration statement with the Commission regarding his offer and sale of the prime bank instruments discussed herein. (Complaint at ¶ 86).

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[4] See, e.g., Complaint at ¶ 28; Weller Aff at ¶ 3; P. Smith Aff. at ¶¶ 2, 4; R. Fan Aff. at ¶ 3.

[5] Laura Nishimura's Declaration is attached hereto as Exhibit 5.

Gilliland instructed most of his investors to wire funds into one of four bank accounts that he controlled, held in the name of Sterling Assets Services, Ltd. ("Sterling Asset") or Sterling Management.[6] On September 16, 1998, Gilliland transferred approximately $20 million from one of the four accounts to an account held by MBC at NationsBank in Charlotte, North Carolina. (Complaint at ¶ 73). In December 1998, the Department of Justice seized the approximately $19 million remaining in the MBC account.

Gilliland also transferred approximately $600,000 of investor funds from one of the four accounts to a bank account in New Zealand in the name of Paramount Insurance Co., Ltd. (June 14 Quilling Decl. at ¶ 5). The New Zealand government froze almost $10 million in this account in November 2000, because it contained proceeds from another apparent prime bank scheme that is unrelated to Gilliland's scheme. A New Zealand court appointed a receiver, called a "release auditor," to administer the return of these funds to investors.

B. Related Proceedings

The United States Attorney's Office for the Northern District of Florida indicted Gilliland in December 2001 on charges of conspiracy to commit wire fraud and securities fraud. The District Court for the Northern District of Florida has issued an arrest warrant for Gilliland, but it has not been executed and Gilliland is currently considered a fugitive.

Prior to Gilliland's indictment, one of Gilliland's investors, George Rollar, filed suit against the United States and others in the Rollar proceeding to recover his investment from the

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[6] Affidavit of Michael Quilling, filed in Rollar v. U.S., C.A. No. 3:01cv205-Mck (W.D.N.C.) at Ex. 1 (Quilling's Affidavit is attached hereto as Exhibit 6). Sterling Asset was an international business corporation organized by Gilliland under the laws of the Isle of Mann. It was dissolved on April 12, 2001. Sterling Management was a corporation organized by Gilliland under the laws of the Turks and Caicos Islands, an overseas territory of the United Kingdom located in the Caribbean. It was dissolved on January 14, 2002.

seized funds. The United States then moved to seek the appointment of a receiver in the Rollar Proceeding for the funds seized at the MBC account at NationsBank. The court appointed a receiver, who is to: 1) notify potential claimants to the seized funds, 2) review claims submitted, 3) recommend a distribution plan to the court, and 4) disburse the funds in the MBC account based upon the court's order.

The Commission instituted this proceeding on March 27, 2002. In its complaint, the Commission sought permanent injunctions and an order requiring disgorgement of ill-gotten gains against Gilliland, together with prejudgment interest. The ill-gotten gains total at least $9.4 million. (June 14 Quilling Decl. at ¶ 6) Prejudgment interest on this amount accruing since March 27, 2002, totals $635,179.31. (Id. at ¶ 7). Gilliland was served with the complaint and summons on June 12, 2002.[7] To date, Gilliland has not filed any answer or any other responsive pleading. Accordingly, on August 5, 2002, the Commission obtained an Entry of Default against Gilliland.

III. DISCUSSION

A. Default Judgment Standard

The Clerk has previously entered a default in this matter. Accordingly, the factual allegations of the Complaint, except those relating to damages, are taken as true. Pope v. United States, 323 U.S. 1, 12 (1944); 10 C. Wright, A Miller & M. Kane, Federal Practice and Procedure § 2688 at 444 (1983) ("If the Court determines that defendant is in default, the factual allegations of the complaint, except those relating to the amount of damages, will be taken as true.").

[7] See June 18, 2002 Notice of Filing Return of Service.

B. Gilliland Violated the Antifraud Provisions of the Federal Securities Laws

Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)] prohibits fraud in the offer or sale of a security. Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5] prohibit fraudulent conduct in connection with the purchase and sale of securities. These provisions make it unlawful to employ, or cause to be employed, devices, schemes or artifices to defraud, or to make any untrue statement of material fact or omit to state material facts in connection with the sale of securities. The Commission must establish that the defendants acted with scienter to prove violations of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5. Aaron v. SEC, 446 U.S. 680 (1980). To prove violations based on misrepresentations or omissions, the Commission must show that the misrepresentations or omissions were material. SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968), cert. denied sub nom, 394 U.S. 976 (1969), reh'd denied 404 U.S. 1064 (1972). A misrepresentation or omission is material if there is a substantial likelihood that under all circumstances it would have assumed actual significance in the deliberations of a reasonable investor. Basic, Inc. v. Levinson, 485 U.S. 224 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976).

The allegations in the complaint, coupled with the supporting affidavits submitted herewith, show that Gilliland violated the antifraud provisions of the securities laws. First, Gilliland misrepresented the very existence of his bank debenture trading programs by failing to disclose that such prime bank securities and trading programs do not exist. See SEC v. Lauer, 52 F.3d 667, 670 (7th Cir. 1995) (stating that "Prime Bank Securities" do not exist). Gilliland also misrepresented the return that investors could expect to receive from the fictitious trading program. Representations about expected rates of return and the safety of investments have long

been recognized to be material. See, e.g., SEC v. The Better Life Club of America, Inc., 995 F. Supp. 167, 177 (D.D.C. 1998) (profit claims are material), aff'd, 203 F.3d 54 (D.C. Cir.), cert. denied sub nom Taylor v. SEC, 528 U.S. 867 (1999); SEC v. Lauer, 864 F. Supp. 784, 788 (N.D. Ill. 1994) (fraudulent promise of 60% annual rate of return is material), aff'd, 52 F.3d 667 (7th Cir. 1995).[8]

Because Gilliland knew that the prime bank program in which he offered and sold interests did not actually exists, he knew or was reckless in not knowing that his representations regarding the existence, risks and likely investment returns of prime bank programs were false. (Complaint at ¶ 78) SEC v. Lauer, 52 F.3d at 670-71 (prime bank instruments do not exist and are inherently fraudulent). Because the trading program did not exist, Gilliland also knew or was reckless in not knowing that his statements regarding his successful trading in these investment programs were false.

C. Gilliland Violated the Securities Registration Provision Of the Federal Securities Laws

Section 5(a) of the Securities Act [15 U.S.C. § 77e(a)] makes it unlawful for any person, directly or indirectly, to use the mails or other means of interstate commerce to sell a security for which a registration statement is not in effect, absent an available exemption. Section 5(c) [15 U.S.C. § 77e(c)] similarly makes it unlawful for any person, directly or indirectly, to offer to sell a security for which a registration statement has not been filed with the Commission, absent an available exemption. Scienter is not an element of a Section 5 violation. SEC v. Softpoint, Inc.,

[8] Gilliland's bank debenture and high-yield trading programs are subject to federal securities laws even if the trading programs did not exist. See Mishkin v. Peat, Marwick, Mitchell & Co., 744 F. Supp. 531, 553 n. 10 (S.D.N.Y. 1990) ("fact that the securities did not exist does not remove this action from the operation of the federal securities laws"). Fictitious instruments, including prime bank instruments, are

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958 F. Supp. 846, 859-60 (S.D.N.Y. 1997), aff'd, 159 F.3d 1348 (2nd Cir. 1998). The Commission makes a *prima facie* case of a Section 5 violation by showing that: (1) a person, directly or indirectly, sold or offered to sell securities; (2) no registration statement was filed or in effect; and (3) interstate means were used in connection with the offer or sale. In this matter, Gilliland violated Sections 5(a) and 5(c) by directly and indirectly offering and selling securities when no registration statements were filed or in effect (Complaint at ¶ 86), and he used the mails and other interstate means in connection with their offers and sales.[9]

D. Gilliland Violated the Broker Dealer Registration Provisions of the Federal Securities Laws

Section 15(a)(1) of the Exchange Act [15 U.S.C. 78(o)(a)(1) makes it unlawful for any "broker" to use the mails or any means or instrumentality of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security," unless registered with the Commission. Scienter is not required to prove a Section 15(a)(1) violation. SEC v. National Executive Planners, Ltd., 503 F. Supp. 1066, 1073 (M.D.N.C. 1980). Section 3(a)(4) of the Exchange Act defines a broker as any person that is "engaged in the business of effecting transactions in securities for the account of others." A person may be found to be acting as a broker if he or she participates in securities transactions "at key points in the chain of distribution." Massachusetts Financial Services, Inc. v. Securities Investor Protection Corp., 411 F. Supp. 411, 415 (D. Mass.) aff'd, 545 F.2d 754 (1st Cir. 1976).

In determining whether a person is a broker, courts have required a showing that there was

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securities. SEC v. Lauer, 52 F.3d at 670 ("[I]t is the representations made by the promoters, not their actual conduct, that determines whether an interest is an investment contract (or other security).")

[9] Once the Commission makes out a prima facie case that the securities offered or sold were not registered, Gilliland bears the burden of demonstrating its entitlement to an exemption from registration.

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a "certain regularity of participation in securities transactions." SEC v. Interlink Data Network of Los Angeles, 1993 WL 603274 at *10, Fed. Sec. L. Rep. (CCH) ¶ 98,049 at 98,474 (C.D. Cal. 1993) (citing SEC v. Hansen, 1984 WL 2413 at *10, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,426 at 98,119 (S.D.N.Y. April 6, 1984)). In making this inquiry, Courts have considered such factors as whether the person (1) is an employee of the issuer, (2) receives commissions as opposed to a salary, (3) sells, or previously has sold, the securities of other issuers, (4) is involved in negotiations between the issuer and the investor, (5) makes valuations as to the merits of the investment or gives investment advice, and (6) is an active rather than passive finder of investors. Hansen, 1984 WL 2413 at *10 In lieu of commissions, courts will consider whether the defendant received some other transaction-based compensation. SEC v. Margolini, 1992 WL 279735 at *5 (S.D.N.Y. Sept. 30, 1992)

During the period from mid-1997 through November 1998, Gilliland acted as a broker because he engaged in the business of effecting transactions in investment contracts for the account of others with the expectation of transaction-based compensation.[10] Moreover, he used the mails and other means of interstate commerce to effect transactions in, and to induce or attempt to induce the purchase or sale of, prime bank securities. He actively solicited investors, and made presentations about his prime bank trading programs to investors around the United States designed to induce the investors to purchase interests in these investment contracts. In addition, Gilliland made valuations as to the merits of the investment. He told investors that they could expect returns ranging from 30% per month to 130% per ten days. He claimed that he had

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Busch v. Carpenter, 827 F.2d 653, 656 (10th Cir. 1987). Gilliland has not and cannot make such a showing.

[10] Gilliland received transaction based compensation because he told investors that he would retain a percentage of their profits from their investments in the trading programs.

invested in these programs and had made "lots of money."

Gilliland was never registered with the Commission as a broker or dealer, nor was he associated with a registered broker or dealer at the time of his fraudulent conduct. He consequently violated Section 15(a)(1) by effecting transactions in, or inducing or attempting to induce the purchase of, securities for the account of others, without being registered with the Commission.

E. A Permanent Injunction Is Appropriate

The Commission may obtain a permanent injunction under Section 20(b) of the Securities Act and Section 21(d) of the Exchange Act. In analyzing the need for injunctive relief, courts focus on whether there is a reasonable likelihood that the defendant, if not enjoined, will engage in future illegal conduct. E.g., SEC v. Bonastia, 614 F.2d 908, 912 (3d Cir. 1980); SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d 90, 100-101 (2d Cir. 1978). In determining the likelihood of future violations, the totality of the circumstances is considered. SEC v. Murphy, 626 F.2d 633, 655 (9th Cir. 1980). Courts consider, inter alia, the egregiousness of the violations, the isolated or repeated nature of the violations, the degree of scienter involved, the likelihood that the defendant's occupation will present opportunities (or lack thereof) for future violations, and the defendant's age and health.

In this case, a permanent injunction, enjoining Gilliland from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder is appropriate against Gilliland because he defrauded hundreds of investors out of millions of dollars, his violative conduct was repeated and egregious, and involved knowing or reckless violations of the federal securities laws. An injunction provides a prospective remedy that would prohibit Gilliland from violating the antifraud provisions in the

future.

F. The Commission Is Entitled to Disgorgement and Prejudgment Interest

Once the Commission has properly invoked the court's equity jurisdiction by seeking injunctive relief, the court has the power to order all equitable relief necessary under the circumstances. SEC v. Materia, 745 F.2d 197, 200 (2d Cir. 1984). In Commission enforcement actions, disgorgement prevents violators from being unjustly enriched, SEC v. Commonwealth Chemical Securities, Inc., 574 F.2d at 102, and enhances the deterrent effect of such actions by making violations unprofitable, SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d. Cir. 1972). Courts clearly have the power to order disgorgement in Commission enforcement actions. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir. 1971). And courts have the authority to order defendants to pay prejudgment interest on ill-gotten gains. SEC v. First Jersey Securities, Inc., 101 F.3d 1450, 1476 (2d Cir. 1996), cert. denied, 118 S. Ct. 37 (1997).

In this matter, Gilliland has received ill-gotten gains of $9.4 million from his fraudulent offerings. (June 14 Quilling Decl. at ¶ 6). The Court should require Gilliland to disgorge these ill-gotten gains. The Court should also require Gilliland to pay $635,179.31 in prejudgment interest. (Id. at ¶ 7).

G. The Court Should Also Impose Civil Penalties.

Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] authorize the Commission to seek court orders imposing civil penalties against any person who has violated those acts. The amount of the civil penalty may equal Gilliland's gross pecuniary gain or:

> (a) [First Tier] $5,000 for a natural person or $50,000 for any other person per violation;

(b) [Second Tier] $50,000 for a natural person or $250,000 for any other person, if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; or

(c) [Third Tier] $100,000 for a natural person or $500,000 for any other person if per violation --

(i) the violation described in subparagraph (A) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(ii) such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.

Securities Act Section 20(d)(2) [15 U.S.C. § 77t(d)(2)]; Exchange Act Section 21(d)(3) [15 U.S.C. § 78u(d)(3)(B)]. In this matter, the Court should impose a civil penalty that reflects the egregious fraud perpetrated by Gilliland.

IV. CONCLUSION

For the foregoing reasons, the Court should enter a default judgment in the form submitted herewith, which orders a permanent injunction, disgorgement plus prejudgment interest and civil penalties.

Respectfully submitted this 13th day of June, 2003.

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CERTIFICATE OF SERVICE

I, M. Graham Loomis, certify that I have served the foregoing SECURITIES AND EXCHANGE COMMISSION'S BRIEF IN SUPPORT OF ITS MOTION FOR DEFAULT JUDGMENT on the Defendant and Relief Defendant by US Mail, postage prepaid, addressed as follows:

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This 13th day of June, 2003

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