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SEC Enforcement Actions: Show Me the Money

Asset protection devices, designed to frustrate recovery efforts, usually do not work.

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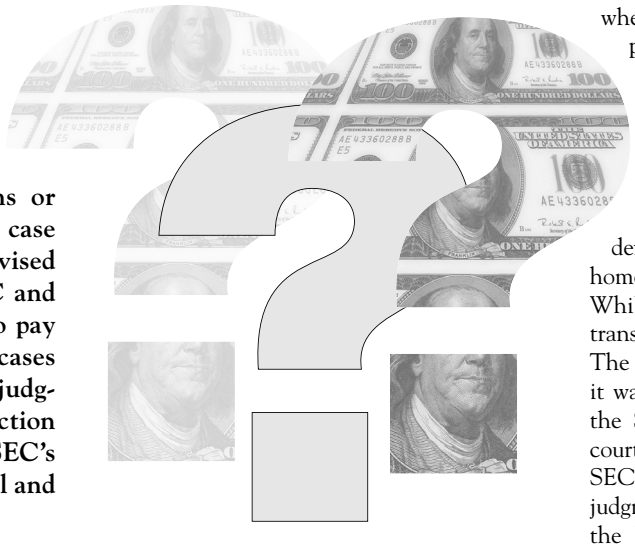

FOLKS PURSUED by the Securities and Exchange Commission engage in all sorts of financial shenanigans to protect their ill-gotten gains or legitimate assets from collection. The case law is just brimming with schemes devised by defendants to bamboozle the SEC and the courts concerning their ability to pay judgments. The decisions in these cases instruct that the SEC is not a typical judgment creditor, and that asset protection devices designed to frustrate the SEC's recovery efforts are largely ineffectual and self-defeating.

This article will address and attempt to debunk the myths surrounding the asset protection mechanisms most commonly utilized in response to SEC enforcement actions.

Myth 1: Homestead property cannot be touched.

The purchase of a homestead property in a debtor-friendly state such as Texas or Florida[1] might serve to protect that asset from private creditors, but it will not necessarily protect it from an SEC judgment.

When the federal government obtains a money judgment against a defendant, such judgment typically constitutes a "debt" subject to the Federal Debt Collection Procedures Act.[2] This Act provides that individual debtors may elect to exempt from recovery by creditors any property that is exempt from debt collection under the state or local law of the debtor's domicile.[3] The Act does not apply to collection of monies owed which are not "debts."[4]

In most cases, the SEC is seeking disgorgement from a defendant of ill-gotten gains from securities law violations. Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating securities laws.[5] The U.S. Court of Appeals for the Fifth Circuit, which hears appeals from district courts in Texas, has ruled consistently that an SEC disgorgement judgment is not a "debt" under the Act, and therefore, the district courts have the discretion to ignore state homestead and other exemptions in deciding whether to hold defendants in contempt for failure to pay SEC disgorgement orders.[6]

That is not to say that the courts will always order a defendant to disgorge his primary residence to pay an SEC judgment.[7] Some courts take into consideration state law property rights, the policies underpinning those rights, and issues of fairness, in reaching their decisions whether to force defendants to disgorge their primary residences. In that regard, a defendant stands the best chance of keeping his home if it is the primary marital residence owned by the de-fendant and his spouse as tenants by the entirety.[8]

For in-stance, in *SEC v. Antar*,[9] defendant Sam Antar and his wife, relief defendant Rose Antar,[10] owned their marital home in New Jersey as tenants by the entirety. While the SEC was pursuing Mr. Antar, he transferred his interest in the home to his wife. The court essentially voided the transfer because it was a fraudulent device designed to frustrate the SEC's collection efforts. Nonetheless, the court, in the exercise of discretion, refused the SEC's request to satisfy its disgorgement judgment by forcing foreclosure or partition of the home. The court took notice that New Jersey courts historically were reluctant to permit interference by creditors with marital homes owned as a tenancy by the entirety, and ruled it would be unfair to dispossess Ms. Antar from her marital home because the SEC's judgment was against Mr. Antar only.[11]

Myth 2: Assets transferred to trusts are unreachable.

Certain types of trusts, utilized under certain conditions, are legitimate estate planning and asset protection devices, which properly may serve to protect the settlors' assets from their creditors. However, if a defendant has transferred ill-gotten gains to a trust without consideration, the SEC may sue the trustees as relief defendants, and a court may order the trustees to disgorge the assets.[12] Also, if a defendant transfers untainted assets to a trust, but does so to frustrate the SEC's ability to collect on a disgorgement judgment, those transfers may be voided by a court as fraudulent transfers under the court's ancillary enforcement jurisdiction.[13]

A court also may choose to hold a defendant in contempt for failure to pay a disgorgement judgment, where the defendant has transferred

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assets out of his purported control to offshore trusts to frustrate the SEC's collection efforts. In *SEC v. Bilzerian*,[14] Paul A. Bilzerian transferred virtually all of his assets into a complex ownership structure of offshore trusts and family-owned companies and partnerships during the pendency of the SEC's action, including after the court entered a disgorgement order against him. One offshore "Family Trust" directly or indirectly owned all of the transferred assets, except for certain assets transferred to a particular trust for Mr. Bilzerian's children. Mr. Bilzerian was the settlor of the trusts, and until a short time before the SEC brought a contempt motion against Mr. Bilzerian for failure to pay the disgorgement judgment, he was both a trustee and beneficiary of the trusts.[15]

Mr. Bilzerian argued he could not be held in contempt for failure to pay the disgorgement order because he had no personal assets to satisfy the judgment. The court found Mr. Bilzerian to be in contempt of its disgorgement order, noting that he had created his alleged inability to pay the judgment himself, by choosing to transfer his assets to the Family Trust and the children's trust. The court further stated: "If he cannot convince the trustees or trust protector to return his assets to him it is a problem of his own making…. To allow Bilzerian to avoid the Court's disgorgement Orders through his contumacious conduct would render both the Court's Orders and the SEC's enforcement power meaningless."[16]

Myth 3: Pension and IRA accounts are off-limits.

Some defendants and potential defendants make maximum annual contributions to their pension and retirement accounts because they believe those contributions will be shielded from SEC collection. For the most part, these persons will be disappointed with the results of this strategy.

It is true that assets in ERISA-qualified pension plans (i.e., plans that meet certain qualifications under the Internal Revenue Code) are strictly off-limits to creditors, including the SEC.[17] However, Employee Retirement Income Security Act protection does not apply to any pension plan that benefits only the sole owner of a business and his spouse, because an employer cannot ordinarily be an employee or participant under ERISA. In *SEC v. Johnston*,[18] defendant claimed that $96,310 belonging to his pension plan was exempt from the SEC's disgorgement order. The court disagreed: "The pension plan at issue covers only Johnston and perhaps his wife and is therefore not an ERISA plan. Disgorgement of the assets in the pension plan is proper."[19]

Assets in Individual Retirement Accounts (IRAs) or 401(k) accounts may or may not be exempt from creditors under the various state laws; however, as discussed above, a federal court's equitable power to order disgorgement trumps all state law exemptions. Further, if ill-gotten gains are deposited into an IRA account, those funds would be subject to disgorgement. Defendants in several SEC cases have consented to disgorgement orders requiring them to liquidate their IRA accounts and hand over the proceeds.[20]

Myth 4: A bankruptcy filing will thwart the SEC's efforts.

Bankruptcy is perhaps the most extreme asset protection device. Bankruptcy law generally prevents creditors from recovering against certain non-exempt assets and future income of the debtor. But a bankruptcy filing is of little utility to a defendant in an SEC proceeding.

The filing of a bankruptcy petition automatically stays civil actions against a debtor,[21] but it does not stay actions "by a governmental unit to enforce such governmental unit's police or regulatory power."[22] The courts have ruled that the SEC's prosecution of a civil fraud action fits within this exception, because the remedies of injunction and disgorgement sought by the SEC are in furtherance of its regulatory powers.[23]

In the wake of a bankruptcy filing, the SEC may continue to prosecute its enforcement action against the bankrupt defendant until it secures a judgment on the merits, at which point any collection efforts are prohibited by the automatic stay provisions of the Bankruptcy Code.[24] At the bankruptcy court, an SEC disgorgement judgment is treated as a general unsecured claim, which is the lowest class of claim paid from the bankruptcy estate. Therefore, if any non-exempt assets are left in the bankruptcy estate after payment of costs of administration, priority claims, and secured claims, the SEC will share those assets pro rata with the other general unsecured creditors.

Generally, the bankruptcy court discharges the bankrupt's debts after the final distribution of non-exempt assets to creditors. However, because a disgorgement judgment in favor of the SEC is nondischargeable in bankruptcy,[25] the SEC may continue to hound the debtor after his emergence from bankruptcy, and attempt to collect on its disgorgement judgment from the debtor's after-acquired assets or income.

Conclusion

Attorneys should discourage their clients from attempting to transfer assets specifically to frustrate the SEC's ability to collect on a possible judgment. In most instances, asset protection maneuvers do not work, and serve only to fuel the SEC's wrath and determination, increase the costs and complications of litigating and settling the action, and subject family members and friends to unwanted, embarrassing, and expensive litigation.

1. By way of example, Florida's Constitution, Article X, §4, provides, in pertinent part, that a homestead property is exempt from "forced sale under process of any court" and that "no judgement, decree or execution shall be a lien thereon…."

2. 28 U.S.C. §3001 et seq.

3. 28 U.S.C. §3014(a)(2)(A).

4. 28 U.S.C. §3001(c).

5. See, e.g., *SEC v. First Jersey Sec. Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996), cert. denied, 522 U.S. 812, 118 S.Ct. 57 (1997).

6. See *SEC v. AMX, International, Inc.*, 7 F.3d 71, 74-76 (5th Cir. 1993); *SEC v. Huffman*, 996 F.2d 800, 802-04 (5th Cir. 1993).

7. Also, when a defendant settles a case with the SEC, the SEC may allow the defendant to keep his primary residence, even if the defendant cannot completely satisfy his disgorgement obligation without disgorging the home. See, e.g., *SEC v. Coates*, 1996 WL 476897, at *4-5 (S.D.N.Y. Aug. 21, 1996) (defendant allowed to retain primary residence and the furniture and household goods therein).

8. That is, assuming the defendant can show that the home was not purchased or improved with ill-gotten gains. See, e.g., *SEC v. The Better Life Club of America, Inc.*, 995 F.Supp. 167, 183 (D. D.C. 1998) (As a gratuitous grantee, relief defendant Lawson is…subject to disgorgement of her interest in the house…."), aff'd, 203 F.3d 54 (D.C. Cir.), cert. denied, 528 U.S. 867, 120 S.Ct. 165 (1999); *SEC v. Belmonte*, 1991 WL 214252 (S.D. Fla. April 25, 1991) (any ill-gotten gains used by defendant to subsidize or otherwise improve his private residence subject to disgorgement).

9. 120 F.Supp.2d 431, 450 (D. N.J. 2000), aff'd, 44 Fed.Appx. 548 (3d Cir. Aug. 2, 2002).

10. Federal courts may order disgorgement "against a person who is not accused of wrongdoing in a securities enforcement action where that person: (1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds." *SEC v. Cavanagh*, 155 F.3d 129, 136 (2d Cir. 1998).

11. See id. at 449-50; see also *SEC v. Yun*, 208 F.Supp.2d 1279, 1284 n. 7 (M.D. Fla. 2002) ("Yun owns her home with her husband as tenant by the entirety. Under Florida state law, one spouse cannot alienate or encumber the estate without the consent of the other…. The Court declines to force Yun to disgorge her home").

12. See generally *SEC v. Antar*, 120 F.Supp.2d at 446-47 (collecting cases).

13. See generally id. at 447-48.

14. 112 F.Supp.2d 12 (D. D.C. 2000), aff'd, 75 Fed. Appx. 3 (D.C. Cir. Sept. 22, 2003).

15. See id. at 19.

16. Id. at 28.

17. See 29 U.S.C. §1056(d)(1) ("Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated").

18. 143 F.3d 260 (6th Cir. 1998).

19. Id. at 263. If at least one person other than the defendant or his spouse is a plan participant, then the plan is ERISA-qualified, and would be exempt from judgment creditors. See *Yates v. Hendon*, 541 U.S. 1, 14, 124 S.Ct. 1330, 1345 (2004).

20. See, e.g., *SEC v. Parkersburg Wireless Limited Liability Co.*, 1994 WL 640127, at *1 (S.E.C. Lit. Release No. 14325) (Nov. 8, 1994).

21. See 11 U.S.C. §362(a)(1).

22. See 11 U.S.C. §362(b)(4).

23. See, e.g., *SEC v. Thrasher*, 2002 WL 523279, at *1 (S.D.N.Y. April 8, 2002).

24. See *SEC v. Brennan*, 230 F.3d 65, 71 (2d Cir. 2000). Further, the automatic stay does not prevent the court from appointing a temporary receiver to take control of the defendant's assets. See generally *SEC v. Wolfson*, 309 B.R. 612, 620-22 (D. Utah 2004).

25. See, e.g., *In re Bilzerian*, 1996 WL 885850, at *1 (M.D. Fla. Oct. 22, 1996), aff'd, 153 F.3d 1278 (11th Cir. 1998) (disgorgement nondischargeable primarily under 11 U.S.C. §523(a)(2)(A)); *In re Telsey*, 144 B.R. 563, 565 (Bankr. S.D. Fla. 1992) (disgorgement nondischargeable under 11 U.S.C. §523(a)(7)).