IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

No. 4:12-cv-00080-CEJ

SECURITIES AND EXCHANGE COMMISSION	)
	)
Plaintiff	)
	)
vs.	)
	)
BURTON DOUGLAS MORRISS, et al.	)
	)
Defendants, and	)
	)
MORRISS HOLDINGS, LLC	)
	)
Relief Defendant	)

REPLY OF RELIEF DEFENDANT MORRIS HOLDINGS TO PLAINTIFF'S RESPONSE TO MORRIS HOLDINGS MOTION FOR A NEW TRIAL OR TO ALTER, OR AMEND JUDGMENT

I. Introduction

Relief defendant Morriss Holdings LLC has moved the Court pursuant to Fed. R. Civ. P. 59 to amend, alter, or set aside the judgment entered in this case on March 22, 2012. Morriss Holdings contends that the plaintiff Securities and Exchange Commission designed this action in significant measure to obtain money from defendants who had sought protection under the federal bankruptcy laws. The filing of the complaint thus violated the automatic stay provision of 11 U.S.C. § 362(a) and was not saved by the automatic stay exception established by 11 U.S.C. § 362(b)(4).

Being in violation of the automatic stay, the SEC's action was void *ab initio, In re Vierkant,* 240 B.R. 317, 321-25 (B.A.P. 8th Cir. 1999), and the Court was without jurisdiction to entertain or take action in the case. *See Constitution Bank v. Tubbs,* 68 F.3d 685, 691 (3rd Cir. 1995) (stating that "[o]nce triggered by a debtor's bankruptcy petition, the automatic stay suspends any non-bankruptcy court's authority to continue judicial proceedings then pending against the debtor") (quoted in *Vierkant,* 240 B.R. at 320). Without subject matter jurisdiction, the Court had no power to proceed in the case beyond declaring the want of jurisdiction and dismissing the action. *Steel Co. v. Citizens for a Better Environment,* 523 U.S. 83, 94 (1998).

II. The Commission's Position

The SEC has made three points in its opposition to Morriss Holdings' motion. It argues first that Morriss Holdings has no standing to challenge the judgment because "[i]t is black-letter law that a non-settling defendant . . . does not have standing to object to another defendant's settlement." Doc. 138, p. 4-5 (citing *In re Beef Industry Antitrust Litigation,* 607 F.2d 167, 172 (5th Cir. 1979)). Second, the SEC contends that the Court is required to deny Rule 59(e) relief because Morriss Holdings could have asserted its objections prior to the entry of judgment on March 22, 2012, but failed to do so. Doc. 138, pp. 6-7. It argues next that its action is for equitable relief only, and not for the recovery of money, and that "crystal clear" law establishes that the automatic stay provision of § 362(a) has no application to this case. *Id.* at 7-10. Finally, as further proof that its

action and the Court's judgment do not violate the automatic stay, the SEC suggests that the receiver's dismissal of bankruptcy proceedings that had been commenced by the entity defendants prior to the initiation of this case extinguished the automatic stay and foreclosed the issue. Id. at 10.

III. Morriss Holdings' Reply Argument

A. Standing

1. The Absence of Subject Matter Jurisdiction Pre-empts Any Question of Standing

By the SEC's design, the complaint in this case intertwines claims for money damages from defendants who were then in bankruptcy with claims for declaratory and injunctive relief. From the inception of the litigation until the entry of the Court's judgment of March 22, 2012, the claims to obtain money from those defendants through "disgorgement" and through the imposition and collection of pecuniary penalties have been part and parcel of the Commission's case.

"Congress clearly intended the automatic stay to be quite broad. Exemptions to the stay, on the other hand, should be read narrowly to secure the broad grant of relief to the debtor." *In re Stringer,* 847 F.2d 549, 551-52 (9th Cir. 1988). The automatic stay provision of § 362(a), properly construed, precluded the SEC from pursuing those claims. In this Circuit, an action taken in violation of the automatic stay is void *ab initio*. *In re Vierkant,* 240 B.R. at 321-25. Once the determination is made that the commencement of this action was a nullity, the

Court's subject matter jurisdiction disappears. *See Steel Co.,* 523 U.S. at 94 (recognizing that "when [jurisdiction] ceases to exist, the only function remaining to the court is that of announcing the fact and dismissing the cause").

That is the correct outcome at this point in the present action. The standing of Morriss Holdings to challenge the judgment pursuant to Rule 59 is beside the point.

2. Morriss Holdings Has Standing to Challenge the Judgment

Morriss Holdings suffers from no want of grievance or standing in any event. The "black-letter" rule cited by the SEC has an equally well-established exception, which is conveniently omitted by the SEC and which the Court of Appeals for *this* Circuit adopted years ago:

> [I]n general, nonsettling defendants lack standing to object to a partial settlement . . . However, in multi-party lawsuits, non-settling defendants often seek the court's intervention to invalidate or alter partial settlements. There is therefore a recognized exception to the general principle [that] permit[s] a non-settling defendant to object where it can demonstrate that it will sustain some formal legal prejudice as a result of the settlement.

Alumax Mill Products, Inc. v. Congress Financial Corp., 912 F.2d 996, 1001-02 (8th Cir. 1990). Through its pleadings and the present judgment, the SEC has pre-engineered the evidentiary swamping of Morriss Holdings in any future hearing to determine whether funds received by this relief defendant are of legitimate or illegitimate origin. Nor has this tilting of the playing field been produced through any neutral truth-finding process that might substitute for a trial with equal evidentiary opportunity. A former federal prosecutor and liquidator to serve as

receiver, Doc. 3, pp. 5-7, and the receiver promptly acceded to precisely the relief that the SEC had pre-ordained with respect to the entity defendants. Doc. 94-1. That surely amounts to "some formal legal prejudice" resulting from the judgment of March 22, 2012.

The SEC argues that the judgment "does not impede Morriss Holdings' ability to raise and assert any defenses . . . in trial or at any subsequent disgorgement hearing" or "restrict in any manner the availability of evidence to Morriss Holdings." Doc. 138, pp. 5-6. It explains that the judgment "[i]nstead focuses solely on the acts of the Investment Entities" and imposes evidentiary limits only on "their ability to challenge a disgorgement and civil penalty amount *as to them."* Id., p. 6 (emphasis in original). That argument writes a check that the judgment as written cannot cover.

Here is what the judgment actually says:

> In connection with the Commission's motion for disgorgement and/or a civil penalty, and at *any hearing held on such a motion:* (a) Acartha Group, MIC VII, ATP, and Gryphon Investments will be precluded from arguing that they did not violate the federal securities laws as alleged in the complaint; (b) [those entities] may not challenge the validity of the Consent or this Judgment; [and] (c) solely for the purposes of such motion, the allegations of the complaint shall be accepted as and deemed true by the Court.

Doc. 101, pp. 4-5 (emphasis added). The language of the judgment (apparently drafted by the SEC, Doc. 95-1) precludes the entity defendants from denying the SEC's fraud allegations *"at any hearing held on . . . a motion"* by the SEC "for disgorgement and a civil penalty." So far only the SEC says that this preclusion

applies solely to motions for disgorgement by or penalty assessment against the entity defendants. Morriss Holdings does not find that authority persuasive.

Even if the Commission's professed interpretation is proved authoritative by judicial adoption at some point in the future, this Court still is predetermined to find—perhaps repeatedly, if the several entity defendants end up needing several hearings to determine their various judgment obligations to disgorge money and pay penalties—that the fraud allegations of the complaint are indisputably true facts. From the point of view of Morriss Holdings, that certainty weights the far side of the scale if the company is called upon to persuade the Court that the origins of its own assets have been *bona fide.* Again, that de-neutralizing of the fact-finding process surely amounts to enough prejudice to justify this Court's consideration of Morriss Holdings' objection to the present judgment.

Finally, the judgment promises legal prejudice in the form of inevitable monetary harm to defendant Burton Douglas Morriss and hence to Morriss Holdings. Dixon Brown, the chief administrative officer of defendant Acartha Group, testified that Mr. Morriss had pledged his carried interest in the entity defendants to secure "the loans that were made to him in Morriss Holdings." Brown Dep. Doc.18-20, pp.6, 8.[1] The judgment of March 22 portends the gross

[1] The SEC explained carried interests in its emergency motion for the appointment of a receiver in this case:

> Acartha Group has two sources of revenue: (1) it collects a 2% management fee of investors' committed capital; and (2) a percentage of carried interest . . . [Burton] Morriss and the

devaluation of Mr. Morriss' carried interest in the investment companies' portfolio assets, and the consequent loss of Morriss Holdings' claim upon the carried interest as loan collateral. By acceding to the Commission's plan to strip the Acartha entities' defenses, this judgment makes it impossible for Morriss Holdings to fight for its rightful percentage of the carried interest. If the judgment is allowed to stand, Morriss Holdings will be precluded from defending these claims, and the Receiver will have carte blanche to liquidate the assets without recourse to the rights of anyone. That financial deprivation also is legal prejudice sufficient to confer standing upon Morriss Holdings for the assertion of its Rule 59 challenge.

B. Morriss Holdings Has Not Failed to Meet Any Requirement of Rule 59(e)

The SEC's apparent suggestion that Morriss Holdings was culpable in failing to assert its objection to the consent judgment prior to the judgment's entry depends upon the Court's willingness to overlook a series of indisputable facts: (a) this relief defendant filed a timely request for additional time within which to respond to the proposal, (b) the Court granted that request, and then (c) the Court entered its judgment *five days prior* to the expiration of the time it had granted—while counsel for Morriss Holdings was in the process of drafting the company's objections and argument. Docs. 98, 99, 101. Perhaps still more to the point, the

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> Investment Entities define carried interest as the net profit from the sale of a private equity fund's portfolio company after investors receive distributions equal to their invested capital in that portfolio company.

Doc. 6, p. 5.

first problem with the judgment in this case is that the SEC commenced its action in violation of the statutory automatic stay, the filing of the complaint and every action taken in pursuit of the recovery of money from the entities that had sought bankruptcy protection have been legal nullities, *Vierkant,* 240 B.R. at 321-25, and the Court lacked subject matter jurisdiction to enter the challenged judgment or make any other ruling in the case beyond dismissal. *Constitution Bank,* 68 F.3d at 691; *see also Steel Co. v. Citizens for a Better Environment,* 523 U.S. 83, 94 (1998) (recognizing that "[w]ithout jurisdiction the court cannot proceed at all in any cause," and "when [jurisdiction] ceases to exist, the only function remaining to the court is that of announcing the fact and dismissing the case").

C. The SEC's Action Always Has Been One to Recover Money Damages From Defendants Who Had Invoked Federal Bankruptcy Protection

It is facile for the SEC to contend that this case seeks only equitable relief and that it was not conceived and has not been prosecuted as one to obtain and enforce a judgment for money against defendants who had invoked the protection of a federal bankruptcy court. Doc. 138, pp. 7-10. The complaint was not limited to seeking only the declaratory and injunctive relief required to stop the alleged fraudulent conduct by investment companies. It prominently and unequivocally sought a judgment requiring "disgorgement" of assets and payment of statutory penalties, as well this Court's retention of jurisdiction to quantify and enforce those awards. The SEC's fanciful re-characterization of its pleading should find no favor with the Court.

Here is what the complaint alleged:

• That defendant Burton Douglas Morriss "fraudulently transferred approximately $9.1 million of investor funds to himself and his family's holding company for personal use" between 2005 and 2011, and that the entity defendants had abetted that conduct by "disguise[ing] the transfers as loans and/or receivables without the knowledge or consent of investors." Doc. 1, p. 1.

Here is the relief that the complaint sought pursuant to its allegations of fraud, beyond a declaration of the correctness of those allegations and the injunction against further violations by the defendants—an injunction that hardly seemed necessary with respect to the entity defendants, control of which would be transferred immediately to a court-appointed receiver:

• An order "directing the Defendants to disgorge all ill-gotten gains, including prejudgment interest," resulting from the actions that were alleged to have occurred from 2005 through 2011, and "directing the Defendants to pay civil money penalties" pursuant to federal securities statutes. Id. at 19-20.

• The retention of jurisdiction by this Court (apparently in favor of the bankruptcy courts whose jurisdiction then controlled the defendants' estates, no decision to dismiss the bankruptcy proceedings having been actually announced quite that early) "to implement and carry out the terms of all orders and decrees that it may order." Id. at 21.

Here is what the SEC's *ex parte* emergency request for a receiver for the entity defendants in bankruptcy sought:

• The immediate appointment of a receiver "with full and exclusive power" to take control of the entities' "funds, assets, choses in action, and any other property," to "marshall" those assets, and to decide whether the bankruptcy proceedings should be dismissed. Doc. 3, pp. 1, 8, 10-11.[2]

Here is what the judgment entered on March 22, 2012, provides:

• The entity defendants "shall pay disgorgement of ill-gotten gains, prejudgment interest thereon, and a civil penalty," the amounts of disgorgement and penalty to be determined by the Court "upon motion of the Commission" and the prejudgment interest to be calculated at "the rate of interest used by the Internal Revenue Service for the underpayment of federal income tax as set forth in 26 U.S.C. § 6621(a)(2)." Doc. 101, pp. 4-5.

• This Court shall retain jurisdiction of the case "for the purposes of enforcing the terms of this judgment." Id. at 5.

That is not "equitable" relief. It is precisely the judgment that the SEC sought from the inception of this case to obtain the money and other property of entities that had invoked the protection of federal bankruptcy law. Nor is there

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[2] In fact the receiver hired counsel in Delaware and filed a successful motion to dismiss the bankruptcy proceedings *less than one week after being appointed by the Court.* Doc. 51-1, pp. 7-8; Doc. 134-1, p. 6. The receiver employed a consultant to advise her with respect to operation of the entity defendants' businesses *after* she had dismissed the bankruptcy proceedings. Doc. 134-1, pp. 7-8. She explained that the consultant was needed to "assist the Receiver in exploring the range of options available under the circumstances and in recommending the appropriate course of action to the Receiver and the Court. Id. The consultant's responsibilities were to include "review[ing] the business operations of the . . . companies and their portfolio companies" and "development of a preliminary business plan for the Receiver." Doc. 134-5, p. 1.

any rational basis for doubting that the SEC and the Court anticipate that this action will conclude with the fixing of the amount of money to be "disgorged" and the amount of penalty to be paid by the defendants, and the enforcement of those awards by the Court rather than by any bankruptcy court. That makes this action one to obtain and enforce a money judgment from defendants that were protected by federal bankruptcy law when the SEC decided to obtain their money and other property. And it makes the action void *ab initio. Vierkant,* 240 B.R. at 321-25.

The SEC insists that Morriss Holdings has misconstrued *City of New York v. Exxon Corp.,* 932 F.2d 1020 (2nd Cir. 1991), and that this opinion "actually holds that [this action] to stop Morriss' and the Investment Entities' fraudulent activities is exactly the type of case to which Section 362(b)(4) applies." Doc. 138, p. 8. Well, not so fast.

The Second Circuit did hold that the automatic stay does not apply to an action in which a government unit is suing to stop or prevent various statutory transgressions, including the violation of environmental protection and fraud laws, "the action or proceeding is not stayed under the automatic stay." *Id.* at 1024 (quoting S.Rep. No. 989, 95th Cong.2d Sess. at 52 (1978)). And the court concluded that allowing a city's action to recover environmental cleanup costs furthered the purpose of the § 362(b)(4) exception by preventing the "'frustration [of] necessary governmental function'" through the commencement of bankruptcy proceedings. *Id.* (quoting *United States v. Seitles,* 106 B.R. 36, 38-40 (S.D.N.Y. 1989)). It explained:

> The availability of a reimbursement action encourages a quick response to environment crises by a government, secure in the knowledge that reimbursement will follow. Such a quick response is a direct exercise of a government's police power to protect the health and safety of its citizens.

932 F.2d at 1024.

But the SEC offers no viable analogy between "necessary government function" required "to protect the health and safety of its citizens" rationale of the Exxon opinion and the appropriation in this case of several debtors' assets and the imposition of civil penalties. Nor does such an analogy exist in logic or common sense. Making no admission of any fact alleged by the SEC in this case, Morriss Holdings does not quarrel with the government's need to halt fraud where fraud actually exists. But what in the world is the government function, essential "to protect the health and safety of its citizens," that is fulfilled by appropriating the properly invoked jurisdiction of a bankruptcy court over the estate of a debtor?

Morriss Holdings also pointed out to this Court that the *Seitles* opinion quoted by the Second Circuit to explain its application of § 362(b)(4) in *Exxon* had framed the essential inquiry as follows:

> The question . . . is whether the present governmental action . . . is a "necessary governmental function" geared towards the "protect[ion] of the public health and safety," or instead, whether this claim is a proprietary governmental function aimed at the protection of pecuniary interests.

106 B.R. at 38, *quoted in Exxon,* 932 F.2d at 1024. Of course that characterization of the issue supports Morriss Holdings' contention that the SEC has overreached and violated the automatic stay in this case. The Commission now has assured the

Court that "the district court vacated *Seitles,* and it is no longer good law." Doc. 138, p. 8 n.4. That is a misleading and untenable bit of argument.

The SEC fails to mention that the vacature was in service of the parties' settlement of their litigation the following year and had nothing to do with the correctness of the bankruptcy court's analysis. *United States v. Seitles,* 742 F.Supp. 1275 (S.D.N.Y. 1990). Indeed, after quoting that analysis the Second Circuit cited *Seitles* as having been "vacated on other grounds." *Exxon,* 932 F.2d at 1024.

The inability of the SEC to recognize the applicability of § 362(a) to this case cannot diminish the importance of that application or the degree of wrong that inheres in and is portended by the present judgment. "The automatic stay is a crucial provision of bankruptcy law." *In re Parr Meadows Racing Association, Inc.,* 880 F.2d 1540, 1545 (2nd Cir. 1989). "Congress clearly intended the automatic stay to be quite broad. Exemptions to the stay, on the other hand, should be read narrowly to secure the broad grant of relief to the debtor." *In re Stringer,* 847 F.2d at 551-52. The SEC has exceeded its authority in prosecuting this action to obtain and enforce a money judgment against companies that had invoked the protection of federal bankruptcy law before the present case was filed.

IV. Conclusion

Relief defendant Morriss Holdings LLC requests that the Court vacate its judgment of March 22, 2012, or alter and amend that judgment, and enter either (a) a judgment finding that the government's action was barred by the automatic

stay provision of § 362(a) to the extent that it sought to obtain money or other assets of defendants Acartha Group LLC, MIC VII LLC, Acartha Technology Partners LP, and Gryphon Investments III LLC, and must be dismissed for want of subject matter jurisdiction, or (b) such alternative judgment as the Court may find just and necessary.

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CERTIFICATE OF SERVICE

I certify that I electronically filed the foregoing on May 2, 2012, with the Clerk of the Court using the CM/ECF system, which will send notification to the following:

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