UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

FAYE B. FEINSTEIN, NOT INDIVIDUALLY, BUT AS RECEIVER FOR WML GRYPHON FUND LLC,

Plaintiff,

Case No. 11-CV-00057

v.

DENNIS J. LONG, INDIVIDUALLY AND IN HIS CAPACITY AS TRUSTEE OF THE DENNIS J. LONG & PATRICIA S. MAGNETTE-LONG JOINT REVOCABLE LIVING TRUST, DATED 5/14/05, AND PATRICIA S. MAGNETTE-LONG,

Defendants.

DEFENDANTS' OPPOSITION TO PLAINTIFF'S CIVIL L.R. 7(h) AND 7(i) EXPEDITED NON-DISPOSITIVE MOTION FOR LEAVE TO FILE A SUR-REPLY BRIEF

Defendants (the "Long Family") object to the Receiver's motion requesting leave to file a sur-reply brief in opposition to the Long Family's motion to dismiss because, as set forth below, it unnecessarily repeats arguments made previously, and lacks merit in any case.

First, the Long Family's reply brief demonstrated that the Receiver takes the unsupportable position that, as a matter of *substantive law*, her authority is unbound by pre-receivership contracts or the Wisconsin state law governing her claims.[1] In her proposed sur-reply, the Receiver feigns confusion over this substantive issue, and instead argues that she has complied with procedural due process by bringing an ancillary action and attempting to allege claims under state law. But it is her

[1] As just one example, the Receiver's Response Brief asserted: "Defendants claim that the Receiver's authority 'is governed by state law and constrained by the order' of appointment. (Defs. Mem. at 13.) In fact, as a receiver is appointed by a federal court, the Receiver's authority derives not from state law, but from 'the inherent power of a court of equity to fashion effective relief." (Resp. Br. at 7-8.)

substantive positions that are inconsistent with due process; the Receiver either deliberately or mistakenly misses this point.

Second, the Receiver's proposed sur-reply repeats her flawed interpretation of the Seventh Circuit's decision evaluating the plan of distribution. The Receiver contends that the Long Family's reply distorts the holding of that case, *SEC v. Wealth Management, LLC*, 628 F.3d 323 (7th Cir. 2010). Although the central holding of that case, which approved the distribution plan, is not directly applicable to this case at all, the Seventh Circuit's holding and reasoning as to when a redeeming member becomes a creditor is important here. In that part of the opinion (quoted in the footnotes), the Seventh Circuit (1) affirmed that at some point a redeeming LLC member becomes a creditor under Wis. Stat. § 183.0606;[2] (2) concluded that the Operating Agreement governs when a member becomes entitled to a distribution and therefore becomes a creditor;[3] and (3) concluded that WM had discretion in the redemption process for approving the timing and scope of redemptions under the Operating Agreement.[4] The Receiver's position in opposition to the motion to dismiss is contrary to each of these conclusions reached by the Seventh Circuit.

The Receiver takes most umbrage with the assertion that the Seventh Circuit's decision means that members with accepted redemption requests prior to the 2% limitation on future redemption requests were entitled to creditor status under Wis. Stat. § 183.0606. But that is the

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[2] "In Wisconsin a holder of an equity interest in a limited-liability company becomes a creditor '[a]t the time that a member becomes entitled to receive a distribution." *Id.* at 335.

[3] "The time at which a member is entitled to receive a distribution is governed by the limited-liability company's operating agreements. *Id.* § § 183.0603, 183.0604. Gryphon is the relevant limited-liability company here, and section 5.3 of Gryphon's operating agreement permits the fund's managing member to restrict distributions when 'existing economic or market conditions or conditions relating to [Gryphon]' render 'withdrawals or payments of withdrawals ... impracticable." *Id.*

[4] "Pursuant to this provision, Gryphon's managing member elected to limit distributions to two percent per quarter of an investor's equity, and in February 2008 all investors received a letter informing them of this restriction on redemptions." *Id.* Notably, none of the appellant members had either made a full redemption request or had a redemption request approved prior to the 2% limitation. *Id.* at 328 ("After receiving the February 2008 letter limiting redemptions to two percent of an investor's equity, Wilson notified Grypon of his intent to redeem his entire investment.... Similarly, on May 1, 2008, the Verhoevens asked to fully redeem their equity.").

most reasonable implication of the court's line drawing for when members become creditors – and they must become creditors at some point – under the statute. They become creditors when and to the extent that the managing member, pursuant to the Operating Agreement and the discretion afforded to it under the agreement, accepts the redemption request. That is clear in the language used by the Seventh Circuit:[5]

Third, the Long Family established in its reply brief that the Receiver had failed to provide this Court with any decisions to support a claw back action either (1) outside of a ponzi scheme context; or (2) where an innocent investor's principal had been recovered.

Indeed, even in further research since the filing of her response and the Long Family's reply, the Receiver has been unable to locate any court decision that permitted the recovery of an investor's principal or any apposite case outside of the ponzi scheme context. The lack of authority for her claims is demonstrated in the sur-reply by her resort to citing a Bloomberg article about a jury verdict in a bankruptcy proceeding (not a Receivership case) involving a ponzi scheme. Further, in the article the bankruptcy estate's lawyer says that verdict is the only known instance of the principal of a redeeming investor in a ponzi scheme being recovered at trial.[6]

With respect to the issue of recovering principal, the Receiver contends that the Long Family misstated the holding of *Scholes*. But the Receiver concedes, as she must, that *Scholes* did not involve such an attempt and so *Scholes* cannot provide support for the recovery of the Long Family's principal. Critically, the Receiver omits from her sur-reply that the reason the Seventh Circuit did not address this issue was because the district court dismissed the fraudulent conveyance

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[5] "The objectors received the two-percent distributions to which they were entitled, but beyond that, pursuant to Gryphon's operating agreement, they were not 'entitled to receive a distribution' and therefore did not become creditors." *Id.* at 335.

[6] In the unpublished case cited in sur-reply, *Lancer Mgt Grp. LLC v. Alpha Fifth Grp.*, 2010 WL 1332844 (S.D. Fla. Mar. 30, 2010), it is unclear whether the case involved a ponzi scheme or not. In addition the case involved recovery of donations made by the fraudsters made to a charity, not the recovery of the return of an innocent investor's principal.

claims as to the principal on summary judgment because that aspect of the claim was barred as a matter of law. (Defs. Reply, p. 13 n.5 citing *Scholes v. Ames*, 850 F. Supp. 707, 715 (N.D. Ill. 1994)).[7] In addition, the logic of *Scholes* is inapposite given the Receiver's position taken in the distribution plan. Far from treating WM as a *Scholes* "evil zombie," the Receiver's plan treats WM as any other innocent investor in the receivership entities.

Fourth, In their reply brief, the Long Family questioned the repeated reference to alleged "back-dating," as if use of that word could cover the legal defects of the complaint, when the plain allegations of the complaint establish that the payments were made long after the redemption would have been affected had there been no "back-dating." The Receiver's proposed sur-reply does not dispute this; instead, it alleges that the Long Family and two other investors received payment from Gryphon after the December 2008 restriction on all new redemptions imposed by WM. This is irrelevant, as under any scenario for the acceptance of the Long Family's January 5, 2007 redemption request, they would have disassociated from Gryphon well before December, 2008.

As movant, the Long Family is entitled to the final brief. The Receiver's attempt to re-argue cases previously cited or correct supposed "mischaracterization" of case law does not support a leave to file a sur-reply. *See Lewis v. Rumsfeld,* 154 F. Supp. 2d 56, 61 (D.D.C. 2001 (denying leave when the "contention does not involve a new matter but rather an alleged mischaracterization . . . ."); *Interphase Garment Sol., LLC v. Fox Tel. Stations, Inc.*, 566 F. Supp. 2d 460, 467 (D. Md. 2008) (sur-reply not permitted when plaintiff "seeks merely to re-open briefing on the issues raised in [a] motion to dismiss and challenge [the movant's] explanations of cited case law.") The Long Family respectfully requests that this Court deny the Receiver's motion.

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[7] The Receiver also repeats her argument on standing with respect to *Knauer* is similarly unnecessary and unsupported. The Long Family has not disputed standing; only that the Receiver's claims are legally insufficient. *Knauer* limited *Scholes* expansive view of fraudulent conveyance and limited view of the *in pari delicto* doctrine to instances where a receiver is seeking recovery of embezzled or as the Receiver quotes in the proposed sur-reply, "diverted funds" (Sur-reply at 5) – facts concededly not present here.

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