

IN THE COURT OF APPEALS

STATE OF ARIZONA

DIVISION ONE

PETER S. DAVIS, court-appointed	)	1 CA-CV 07-0546
Receiver for Trend Management Group,	)	
Inc., Trend Capital, LLC, and The Trend	)	
Group,	)	MARICOPA COUNTY
	)	Superior Court
Appellant,	)	No. CV2006-016822
	)	
vi.	)	
	)	
ARMANDO NAVAS, SR. and GISELLE	)	
NAVAS, husband and wife,	)	
	)	
Appellees.	)	
	)	
	)	

OPENING BRIEF OF APPELLANT  
PETER S. DAVIS, COURT-APPOINTED RECEIVER

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## STATEMENT OF THE CASE AND STATEMENT OF FACTS

This appeal arises from an order, in a receivership case, involving the claimed priority of two investors in an investment scheme. The order is final for appeal purposes based upon its inclusion of Rule 54(b), Ariz. R. Civ. P., language. Accordingly, pursuant to A.R.S. §12-2101(B), the Court of Appeals has jurisdiction over this appeal.

On November 2, 2006, the Arizona Corporation Commission filed a petition seeking the appointment of a Receiver for Trend Management Group, Inc. (“Trend Management”) and Trend Capital, L.L.C. (“Trend Capital”) based upon allegations that Trend Management, an insolvent entity, and Trend Capital, had sold unregistered securities in violation of A.R.S. §44-1841, through unregistered dealers and salesman in violation of A.R.S. §44-1842, and had committed fraud in the sale or purchase of securities in violation of A.R. S. §44-1991.<sup>1</sup>

The underlying facts alleged in support of the petition for the appointment of a Receiver are set forth in Exhibit “A” to the petition, i.e., the “Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, Order for Restitution, Order for Administrative Penalties and for Other Affirmative Action,” (the “Notice of Opportunity for Hearing”) filed by Arizona Corporation

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<sup>1</sup> See, Appeal Index Item No. 1 (“Verified Petition for Appointment of Receiver,” filed November 2, 2006).

Commission.<sup>2</sup> In essence, the Arizona Corporation Commission alleged that Trend Management (and others) sold unregistered securities in Trend Management<sup>3</sup> and unregistered securities in Trend Capital. As to the latter sales of unregistered securities, more than \$8,900,000.00 was raised from over 300 investors through the sale of unregistered securities, called "Certificates of Participation" in Trend Capital, by unregistered salespeople.<sup>4</sup> The investors "were largely unaccredited and unsophisticated. Many of the investors were elderly."<sup>5</sup> It was further alleged that: neither Trend Management nor Trend Capital was registered to sell securities in the State of Arizona; and, further, investors were not told, among other things,

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<sup>2</sup> See, Appeal Index Item No. 1 ("Exhibit A" incorporated by reference in the "Verified Petition for Appointment of Receiver," [2:2-3], filed November 2, 2006).

<sup>3</sup> It was alleged that approximately 28 individual investors purchased approximately \$1,000,000.00 in "preferred shares" in Trend Management. (See, Appeal Index Item No. 1 [Exhibit "A" to Verified Petition for Appointment of Receiver, 4:18-25].) The Arizona Corporation Commission alleged that Trend Management falsely represented to investors that its stock was a security that was exempt from registration. (See, Appeal Index Item No. 1 [Exhibit "A" to Verified Petition for Appointment of Receiver, 8:5-6].) Further, it was alleged that Trend Management was not registered to sell securities in the State of Arizona. (See, Appeal Index Item No. 1 [Exhibit "A" to Verified Petition for Appointment of Receiver, 6:18].)

<sup>4</sup> See, Appeal Index Item No. 1 (Exhibit "A" to Verified Petition for Appointment of Receiver, 5:3-25; 9:4-25; 10:1-9). It is the Receiver's understanding that the Appellees fall within this group of 300 investors.

<sup>5</sup> See, Appeal Index Item No. 1 (Exhibit "A" to Verified Petition for Appointment of Receiver, 5:24-26).

that some of the monies they were investing in Trend Management, or Trend Capital, were to be used as personal loans to specific persons directly involved in the securities fraud.<sup>6</sup> The Arizona Corporation Commission asked for the appointment of a Receiver “[i]n order to determine all persons having valid claims against the assets of Defendants [Trend Management and Trend Capital] and to protect existing assets for the benefit of such persons . . . .”<sup>7</sup>

On November 8, 2006, Trend Management and Trend Capital, through their respective chief executive officers, consented to the appointment of a Receiver in the receivership action brought by the Arizona Corporation Commission.<sup>8</sup> On November 20, 2007, the Court entered an Order (the “Receivership Order”) appointing Peter S. Davis, Simon Consulting, L.L.C., as Receiver for all of the assets of Trend Management and Trend Capital.<sup>9</sup> By this Receivership Order, all persons, who received notice, were enjoined from interfering with the operation of the Receivership, or in any way disturbing the Receivership Assets, or from filing

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<sup>6</sup> See, Appeal Index Item No. 1 (Exhibit “A” to Verified Petition for Appointment of Receiver, 17:4-17; 18:15-24; 19:1-25; 20:1-19).

<sup>7</sup> See, Appeal Index Item No. 1 (“Verified Petition for Appointment of Receiver,” 2:14-16).

<sup>8</sup> See, Appeal Index Item No. 2 (“Consent to Appointment of Receiver,” filed on November 8, 2006.)

<sup>9</sup> See, Appeal Index Item No. 5 (“Order Appointing Receiver,” filed on November 20, 2006).

or prosecuting any actions or proceedings which involved the Receiver or which affected the Receivership Assets.<sup>10</sup> Further, all persons (except those with leave of the Receivership Court) were stayed from taking any action to establish or enforce claims, rights, or interests against Trend Management or Trend Capital. The stay prevented persons from “executing, issuing, serving, or causing the execution, issuance or service of, any legal process, including, but not limited to, attachments, garnishments, subpoenas, writs of replevin, writs of execution, or any other form of process . . .”<sup>11</sup> The Receiver was ordered to “prevent the inequitable distribution of assets and determine, adjust, and protect the interests of persons with an interest in or claim against the Receivership Assets.”<sup>12</sup> The Receiver was also ordered to marshal the assets of the Receivership.<sup>13</sup>

On January 31, 2007, the Court entered “Order Re Petition No. 2 Order Governing the Administration of the Receivership” wherein the Receiver was

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<sup>10</sup> See, Appeal Index Item No. 5 (“Order Appointing Receiver,” 3:13-24; 5:25-26; 6:1-21).

<sup>11</sup> See, Appeal Index Item No. 5 (“Order Appointing Receiver,” 5:25-26, 6:1-4, 13-16).

<sup>12</sup> See, Appeal Index Item No. 5 (“Order Appointing Receiver,” 5:14-16).

<sup>13</sup> See, Appeal Index Item No. 5 (“Order Appointing Receiver,” 5:17-24; 8:9-26; 9:1-16; 10:9-17).

directed to establish a claims procedure by which all those who wished to assert a claim against the Receivership assets could do so through an orderly process.<sup>14</sup>

Just as the receivership was underway, the Appellees filed a motion to enforce a garnishment judgment it had previously obtained against Trend Management, prior to the appointment of the Receiver.<sup>15</sup> In their motion, the Appellees claimed that they had brought an action against Trend Capital and Trend Management for, among other claims, “fraud in the inducement, securities fraud, federal securities violation and rescission . . . based on their loss of an investment of \$126,221.23”<sup>16</sup> Thereafter, Appellees asserted, they had obtained a default judgment against Trend Capital and, subsequently, obtained a garnishment judgment against Trend Management for (an increased amount of) \$157,210.84.<sup>17</sup>

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<sup>14</sup> See, Appeal Index Item No. 25 (“Order Re: Petition No. 2 Order Governing the Administration of the Receivership,” entered on January 31, 2007, 4:20-21; 5:1-21; 6:1-21).

<sup>15</sup> See, Appeal Index Item No.18 (“Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.,” filed on or about January 24, 2007). The Garnishment Judgment was entered on October 23, 2006.

<sup>16</sup> See, Appeal Index Item No.18 (“Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.,” 1:23-27).

<sup>17</sup> See, Appeal Index Item No.18 (“Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.,” 1:27; 2:1-8; exhibit “A” to motion).

The garnishment judgment stated:

The Appellees sought to compel the Receiver to immediately pay the garnishment judgment they had obtained against Trend Management so that they could fully collect on the underlying debt owed to them by Trend Capital.<sup>18</sup>

The Receiver responded to the Appellees' motion and argued that compelling the Receiver to immediately pay the garnishment judgment would prefer the Appellees over other investors. Such a preference would violate the tenet of equitable receivership proceedings requiring that similarly treated claimants (here, defrauded investors) be treated equally. The Receiver continued that, since the receivership entities were insolvent, this meant that no other investors would be

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IT IS ORDERED, ADJUDGED AND DECREED that Plaintiffs Armando Navas, Sr. and Giselle Navas have judgment against Trend Management Group, Inc. in the principal amount of \$157,210.84;

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Garnishee Trend Management Group, Inc., shall immediately transfer the adjudged monies in the amount of \$157,210.84 to Plaintiffs/Judgment Creditors.

(See, Appeal Index Item No.18 ("Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.," Exhibit "A", 1:23-28).

<sup>18</sup> See, Appeal Index Item No.18 ("Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.," 3:22-24).

The Appellees also claim that Trend Management was served with the garnishment, but provided no specific date, or proof, of service in their motion. (See, Appeal Index Item No. 18 ["Motion to Enforce Judgment against Garnishee Trend Management Group, Inc.," 2:8-10.]) The Receiver does not dispute that Trend Management was aware of the existence of the garnishment judgment.

It is noted that Appellees never obtained a garnishment judgment against any bank at which Trend Management may have an account(s).

able to fully recover on their principal investment. Further, the Receiver argued that he had not even had time yet to put into place a claims process by which all investors could file their claims against the receivership assets.<sup>19</sup>

Subsequently, the Appellees filed a Reply in support of their motion and the Court took the matter under advisement.<sup>20</sup> Following a hearing on the matter on April 16, 2007, the Honorable Ruth Hilliard<sup>21</sup> entered a minute entry, dated April 20, 2007, denying the Appellees' request to lift the stay enjoining all persons from interfering with the assets of the Receivership estate.<sup>22</sup> The minute entry, however, also stated the following:

The Interested Parties obtained a default judgment against Trend Management Group, Inc. on October 24, 2006 and instituted garnishment proceedings against Trend Management Group, Inc.'s assets on December 1, 2006. Although the judgment was obtained prior to the creation of the receivership, the Interested Parties began their garnishment proceedings after the Order Appointment Receiver was entered."<sup>23</sup>

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<sup>19</sup> See, Appeal Index Item No. 29 ("Receiver's Response to Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.," filed on February 7, 2007).

<sup>20</sup> See, Appeal Index Item No. 32 ("Navases' Reply in Support of Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.," filed on February 20, 2007).

<sup>21</sup> Judge Hilliard has since been transferred to another division of the Superior Court. The new judge assigned to this case is the Honorable A. Craig Blakey, II.

<sup>22</sup> See, Appeal Index Item No. 54 ("Minute Entry dated April 20, 2007," entered on April 27, 2007).

<sup>23</sup> See, Appeal Index Item No.54 ("Minute Entry," dated April 20, 2007, filed on April 27, 2007)

The Appellees then filed a Rule 60(c)(1), Ariz. R. Civ. P., motion and argued that the Superior Court had mistakenly stated, in its April 27<sup>th</sup> minute entry, that the garnishment judgment had been obtained on December 1, 2007 rather than October 24, 2006.<sup>24</sup> (In fact, the proper sequence of events is, as follows: the Appellees took a default judgment against Trend Capital and, thereafter, obtained a garnishment judgment against Trend Management, on October 24, 2007. The Appellees argued that they had mistakenly caused some confusion regarding *when* the garnishment judgment had been entered. Appellees then argued that since they had obtained their garnishment order prior to the appointment of the Receiver, the Court should vacate its minute entry and permit them to enforce their garnishment judgment against the Receiver.)

The Receiver filed a Response<sup>25</sup> and a hearing was held on the matter on May 10, 2007. Subsequently, the Court entered a minute entry reversing its previous ruling and held that since the garnishment judgment had been entered

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<sup>24</sup> See, Appeal Index Item No. 60 (“Rule 60(C)(1) Motion for Relief from this Court’s April 20, 2007 Order on the Basis of Mistake Or Inadvertence,” filed on May 1, 2007).

<sup>25</sup> See, Appeal Index Item No. 62 (“Response to Rule 60 (C)(1) Motion for Relief From This Court’s April 20, 2007 Order On The Basis Of Mistake Or Inadvertence,” filed on May 8, 2007).

before the appointment of the Receiver, the Appellees were entitled to have their garnishment judgment paid by the Receiver from the receivership assets.<sup>26</sup>

The Receiver then filed Petition No. 10 requesting a modification of the Court's Order in order to prevent a preferential, and inequitable, distribution of the Receivership Assets to the Appellees, and to delay payment to Appellees until completion of a formal claims process during which all claims in the Receivership could be considered and determined.<sup>27</sup> This motion was opposed by the Appellees who argued, among other things, that their garnishment judgment afforded them a "superior claim" in comparison to the claims of all other investors and the existence of the garnishment judgment, in essence, exempted them from having to share in the receivership assets on a *pro rata* basis with all the other defrauded investors.<sup>28</sup> This was filed concurrently with a motion by the Appellees for an

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<sup>26</sup> See, Appeal Index Item No. 64 ("Minute Entry," dated May 10, 2007, entered on May 11, 2007).

<sup>27</sup> See, Appeal Index Item No. 68 ("Petition No. 10 Petition For Modification Of Order, Or, Alternatively, For Final Judgment And Authority To Appeal," filed on May 16, 2007).

In this motion, the Receiver stated that as of May 14, 2007, the Receiver had identified approximately 350 investors, including the Appellees, who had invested approximately \$16.1 million dollars with the receivership entities, and, based upon current and projected asset recoveries, the Receiver did not expect to recover sufficient assets to wholly satisfy all anticipated receivership claims.

<sup>28</sup> See, Appeal Index Item No. 81 ("Response To Petition For Modification Of Order, Or, Alternatively, For Final Judgment And Authority To Appeal," filed on May 29, 2007).

expedited ruling on the Receiver's Petition for Modification of the May 10, 2007 minute entry.<sup>29</sup>

Thereafter, the Court entered another minute entry on June 1, 2007 which granted the Receiver's Petition for Modification of Order only to the extent that Rule 54(b) language was to be added.<sup>30</sup> (In the meantime, an "Amended Order Appointing Receiver" was entered on May 17, 2007 expanding the receivership to include The Trend Group as another receivership entity.<sup>31</sup>)

The Receiver, thereafter, lodged an Order<sup>32</sup> which was opposed by Appellees.<sup>33</sup> An Order to enforce the garnishment judgment against the Receiver was entered on June 14, 2007.<sup>34</sup> In the Order, the Court stated that the Receiver

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<sup>29</sup> See, Appeal Index Item No. 80 ("Motion For Expedited Ruling On The Receiver's Petition For Modification Of Order, Or, Alternatively, For Final Judgment And Authority to Appeal," filed on May 29, 2007).

<sup>30</sup> See, Appeal Index Item No. 87 ("Minute Entry," dated May 30, 2007, entered on June 1, 2007).

<sup>31</sup> See, Appeal Index Item No. 17 ("Amended Order Appointing Receiver," entered on May 17, 2007).

<sup>32</sup> See, Appeal Index Item No. 88 ("Notice Of Lodging Order To Enforce Judgment Against Garnishee Trend Management Group, Inc.," filed on June 1, 2007).

<sup>33</sup> See, Appeal Index Item No. 89 ("Objection to the Receiver's Proposed Order And Request for Expedited Hearing," filed on June 4, 2007).

<sup>34</sup> See, Appeal Index Item No. 92 ("Order To Enforce Judgment Against Garnishee Trend Management Group, Inc.," entered on June 14, 2007).

must pay post-judgment interest on the garnishment judgment at the rate of 10% from the date of the October 24, 2006 garnishment judgment (which meant that the Receiver would now have to pay the Appellees tens of thousands of dollars more than the Court issuing the garnishment judgment had awarded to the Appellees), and the Court lifted the receivership stay prohibiting the Receiver from paying any receivership assets.<sup>35</sup>

A Notice of Appeal was filed on June 27, 2007,<sup>36</sup> and an Amended Notice of Appeal was filed on June 29, 2007.<sup>37</sup> (A supersedeas bond was filed by the Receiver-Appellant with approval from the Superior Court.)<sup>38</sup>

### **STATEMENT OF ISSUES ON REVIEW**

Did the Trial Court err in permitting the Appellees to be fully compensated on their investment loss (indeed, to recover even more than their principal loss) while other anticipated investors, who also lost their investments through the

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<sup>35</sup> See, Appeal Index Item No. 92 (Exhibit "A," to "Order To Enforce Judgment Against Garnishee Trend Management Group, Inc.," entered on June 14, 2007).

The original Garnishment Judgment did *not* provide for an award of post-judgment interest. (See, Appeal Index item no.18 ("Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.," Exhibit "A.")

<sup>36</sup> See, Appeal Index Item No. 96 ("Notice of Appeal" filed on June 27, 2007)

<sup>37</sup> See, Appeal Index Item No. 100 ("Amended Notice of Appeal" filed on June 29, 2007)

<sup>38</sup> See, Appeal Index Item Nos. 101, 102 ("Order Approving Supersedeas Bond" dated June 27, 2007, entered on June 29, 2007; "Stipulation Re: Supersedeas Bond" filed on June 27, 2007).

alleged underlying fraud, will have to share ratably in the insolvent receivership estate leaving the remaining investors with less than a full recovery?

Did the Court err in lifting the receivership stay so that the Appellees would be paid from the receivership assets of Trend Management before the Receiver had an opportunity to marshal all receivership assets and review all receivership claims (in order to determine things such as whether Trend Management has *any* monies belonging to it [as opposed to holding monies in constructive trust for all defrauded investors], and whether there exist any other competing liens, or secured interests, against the garnishee, Trend Management?

### **SUMMARY OF ARGUMENT**

The receivership proceeding in this matter is *equitable* in nature. It is a long-established tenet, under Arizona law, that similarly-situated receivership claimants (in this case, persons who were sold unregistered securities involved in a fraud scheme) must be treated equally. As such, all persons who have claims against the receivership assets must present their claims through a court-approved receivership claims process at the conclusion of which all claims will be considered so that equitable treatment of the claimants can be determined. The Court erred in permitting the Appellees to “leap-frog” over this process thereby ensuring the *inequitable* treatment of the investors in this receivership action.

Additionally, even if the Appellees had established a lawful priority over all other investors, lifting the stay so that the Appellees could be immediately paid on their garnishment judgment was premature. It may well turn out that the monies held by Trend Management do not belong to Trend Management, but are held in constructive trust for all who may have been victimized by the fraud that forms the basis for this receivership.<sup>39</sup> As the facts of this case are unraveled, and the claims of other investor-victims are received and analyzed, the Receiver in the future will be better able to determine what monies held by Trend Management, or in a bank account in its name, actually belong to Trend Management (and, thus, could properly be applied to a garnishment judgment where appropriate to do so).

Accordingly, the decision of the Superior Court lifting the receivership stay, and permitting the immediate enforcement of the garnishment judgment from the receivership assets of Trend Management, was an abuse of discretion.

## ARGUMENT

### **I. Standard of Review**

The Superior Court's Order granting the Appellees' a priority over all other investors because of their garnishment judgment against Trend Management, and

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<sup>39</sup> A constructive trust is "an equitable remedial device, generally used to prevent unjust enrichment. (Citation omitted.) In particular, a constructive trust will arise whenever it is inequitable that property should be retained by the legal title holder." *Burch & Cracchiolo, P.A. v. Pugliani*, 144 Ariz. 281, 285, 697 P.2d 674, 678 (Ariz. 1985).

adding an award of post-judgment interest to the garnishment judgment, is based upon legal errors which require *de novo* review on appeal. (See, *U.S. v. Acorn Technology Fund, L.P.*, 429 F.3d 438, 442 (3<sup>rd</sup> Cir. 2005) [holding *de novo* review was appropriate over District Court's application of law in receivership proceedings]; see also, *S.E.C.v. Credit Bancorp, Ltd.*, 290 F.3d 80, 87 (2<sup>nd</sup> Cir. 2002).

The Court's decision to lift the receivership stay (that had prohibited the Receiver from paying any receivership assets) for the purpose of paying the entire amount of Appellees' garnishment judgment was an abuse of discretion. (See, *U.S. v. Acorn Technology Fund, supra*, 429 F.3d at 442 [holding the District Court's decision regarding the grant, denial or modification of an injunction in a receivership proceeding is reviewed for an abuse of discretion]; see also, *S.E.C. v. Universal Financial*, 760 F.2d 1034 (9<sup>th</sup> Cir.1985).)

## **II. The Appellees are not entitled to a priority.**

A receivership is an equitable proceeding in which all of the property of the receivership defendants is transferred from the custody of the receivership defendants to the custody of Receivership Court so that the property, ultimately, may be equitably distributed to recognized claimants of the receivership estate. (See, *S.E.C. v. Cook*, 2001 WL 256172, p.2 (D.C. Tex. 2001) (holding, "[a]fter all,

the very purpose of a receivership is to secure the assets of the corporation for ultimate payment to the creditors.”)

Receiverships are *in rem* proceedings:

A receivership is an equitable proceeding, remedy, or matter and is entirely within control of the court and is administered on equitable principles. The appointment of a receiver is made by a court of equity in the performance of one of its prerogative functions in order to enable it to accomplish, as far as practicable, complete justice between the parties before it. The purpose of a receivership is to preserve the property which is the subject of the litigation and to provide full protection to the parties' rights to the property until a final disposition of the issues and it is for the benefit of all concerned.

The remedy of receivership is not only an extraordinary one, but is also a harsh remedy, and in some case it has been held a severe, dangerous, drastic, radical, and heroic remedy. The appointment of a receiver is variously stated to be in the nature of, or is treated as in effect, an attachment, sequestration, or equitable execution before judgment, although receivership, as a remedy, is not a substitute for attachment. Also, receivership has been considered to be in the nature of, and in effect, an injunction; but the rights to the two remedies are essentially distinct. A receivership proceeding is an *in rem* or a quasi *in rem* proceeding. (Footnotes omitted.)

75 C.J.S. *Receivers* §3 (2002).

Receiverships, as in the instant case, are often put into place where receivership defendants have been accused of committing fraud against numerous victims. (See, e.g., *S.E.C. v. Credit Bancorp, Ltd.*, 290 F.3d 80 (2<sup>nd</sup> Cir. 2002); *S.E.C. v. Elliott*, 953 F.2d 1560 (11<sup>th</sup> Cir. 1992) (“*S.E.C. v. Elliott, I*”), *rev'd in part on other ground*, *S.E.C. v Elliott*, 998F.2d 922 (11<sup>th</sup> Cir. 1993). By doing so, the victims of the fraud can share in a recovery against the receivership assets on

an equitable basis which generally involves a *pro rata* distribution of receivership assets.

Here, the Arizona Corporation Commission brought allegations of fraud against Trend Management and Trend Capital in the sale of unregistered securities,<sup>40</sup> and sought the appointment of a Receiver so that the assets of the receivership defendants could be brought under the control of the Receivership Court for preservation and so that there could be an ultimate equitable distribution of the receivership assets to recognized creditors of the receivership estate,<sup>41</sup> which, in cases such as this, are typically the victims of the underlying fraud.

The Receiver is an agent of the Court whose role it is to aid the Court in the marshalling, and ultimate equitable distribution, of the assets of the receivership estate. (*See, Stowell v. Arizona Savings and Loan Ass'n*, 93 Ariz. 310, 380 P.2d 606 (Ariz. 1963) (holding that a receiver is a ministerial officer of the court appointing him).) In this case, the Receivership Court ordered the Receiver to marshal and preserve the receivership assets by doing, among other things, the following:

The Receiver is hereby authorized to make such ordinary and necessary payments, distributions, and disbursement as he deems advisable or proper

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<sup>40</sup> *See*, Appeal Index No. 1 (Exhibit "A," 18:12-24; 19:1-25; 20:1-19, to "Verified Petition for Appointment of Receiver").

<sup>41</sup> *See*, Appeal Index No. 1 ("Verified Petition for Appointment of Receiver," ¶6).

for the marshaling, maintenance or preservation of the Receivership Assets.<sup>42</sup>

The Receiver is hereby authorized to employ such employees, accountants, and attorneys as are necessary and proper for the collection, preservation and maintenance of the Receivership Assets.<sup>43</sup>

One of the primary tenets of a receivership is the equitable treatment of like-situated creditors. (*See, Sisk v. White*, 50 Ariz. 103, 69 P.2d 242 (Ariz. 1937) (holding that the Receiver must treat all creditors of the same class on an equal basis).) This is the equitable underpinning of all equitable receiverships and is accomplished through the claims process. (In this case, the framework for an ultimate claims process was established by the Court's Order re: Petition No. 2.)<sup>44</sup>

In *S.E.C. v. Credit Bancorp, Ltd.*, *supra*, the Court approved the Receiver's proposed distribution plan where all fraud victims would share in the receivership assets on a *pro rata* basis even though a group of victims claimed priority over other fraud victims because they transferred identifiable shares of stock to the defrauder rather than cash as had the other victims. In *S.E.C. v. Elliott I*, *supra*, the Court refused to allow certain investors to recoup more on their losses even though

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<sup>42</sup> See, Appeal Index No. 5 ("Order Appointing Receiver," ¶10).

<sup>43</sup> See, Appeal Index No. 5 ("Order Appointing Receiver," ¶18).

<sup>44</sup> See, Appeal Index No. 25 ("Order Re: Petition No. 2 Order Governing the Administration of the Receivership," ¶5, entered on 1-31-07).

some investors could identify the securities they had transferred to the defrauder.

The Appellate Court approved the Order of the District Court which stated:

To allow any individual to elevate his position over that of other investors similarly “victimized” by asserting claims for restitution and/ or reclamations of specific assets based upon equitable theories of relief such as fraud, misrepresentation, theft, etc. would create inequitable results, in that certain investors would recoup 100% of their investment while other would receiver substantially less. . . . .

*S.E.C. v. Elliott, supra*, 953 F.2d at 1569.

In fact, the Receivership Court, in the instant matter, ordered the Receiver to:

. . . prevent the inequitable distribution of assets and determine, adjust, and protect the interests of persons with an interest in or claim against the Receivership Assets.<sup>45</sup>

While any Receiver would prefer to fully compensate each victim of a fraud underlying the receivership, this, unfortunately, is rarely possible. The Receiver can only distribute (subject to Court approval) those assets that are recovered. If the recovered assets (less expenses) do not equal or exceed total claims, the victims must share *pro rata* in the receivership estate in order to be treated equitably.

*S.E.C. v. Credit Bancorp, Ltd., supra*; *S.E.C. v. Elliott I, supra*; *S.E.C. v. Drucker*, 318 F.Supp.2d 1205 (D.C. Ga. 2004).

In order to determine how to treat receivership claimants in an equitable manner, the Court directs the Receiver to establish a claims process whereby

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<sup>45</sup> See, Appeal Index No. 5 (“Order Appointing Receiver,” ¶11).

anyone, who believes he has a claim against the receivership estate, may set forth the basis for his belief and the amount claimed to be due from the receivership estate. Through that process, the Court can view all claims and decide which claimants are like-situated so that all claimants within a class can be equitably treated. If there is more than one class of claimants, the Court can then determine the equities of treating one class differently than another, e.g., victims may be paid before general commercial creditors.

In this case, the Superior Court permitted the Appellees to leap-frog over the entire claims process, as well as over all other claimants, based upon the Appellees' claim that they had a priority because they had obtained a garnishment judgment prior to the appointment of the Receiver. Yet, this alone, did not give the Appellees a priority in the receivership. *See, Jackson v. PhoenixFlight Productions, Inc.*, 145 Ariz. 242, 247, 700 P.2d 1342, 1347 (Ariz. 1985) holding that "it is not until a plaintiff obtains a judgment against the garnishee *and executes upon that judgment* that a lien is created." (Emphasis added.) Appellees failed to prove below that they had executed upon their garnishment judgment.

Accordingly, the Appellees had no lien in any receivership assets, no priority rights to such assets, and no right to immediate payment of the full amount of the garnishment judgment from such assets.

(Additionally, a garnishor only takes, against a garnishee, the same rights that the garnishor's debtor had against the garnishee. *See, Ellery v. Cumming*, 40 Ariz. 512, 14 P.2d 709 (Ariz. 1932). In this case, the garnishee is insolvent and has been placed into receivership. The Appellees failed to prove that the underlying debtor, i.e., Trend Capital, would have been entitled to anything more than a *pro rata* distribution from Trend Management's insolvent receivership estate. If Trend Capital would not be entitled to more than a *pro rata* distribution from Trend Management's insolvent receivership estate, then neither would the Appellees.)

Further, and importantly, the Receivership Court erred in providing for an award of post-judgment interest which was NOT originally awarded in the garnishment judgment. If Appellees originally requested the Court issuing the garnishment judgment to provide for an award of post-judgment interest, that request clearly was declined since none was provided for in the award.<sup>46</sup> There is no legal basis for the Receivership Court to modify the garnishment judgment to provide for a greater award than originally provided to the garnishor, particularly in this case where such additional monies would have to be paid from receivership assets that would leave even less for distribution to all remaining investors, who will not be able to wholly recover on the principal amount of their investment.

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<sup>46</sup> *See*, Appeal Index item no.18 (Exhibit "A" to "Motion to Enforce Judgment Against Garnishee Trend Management Group, Inc.").

Accordingly, the Order enforcing the garnishment judgment must be reversed as it lacks a legal basis in affording the Appellees with a priority and, in effect, inappropriately modifies the original garnishment judgment to add an additional award of post-judgment interest.

**III. The District Court abused its discretion in lifting the receivership stay when the receivership was only six months old.**

First, as the party requesting that the receivership stay be lifted (as to their claims), Appellees had the burden of proving that the stay should be lifted. *See, U.S. v. ESIC Capital, Inc.*, 675 F.Supp. 1462 (D.C. Md. 1987).

Second, although there is no Arizona case on point, the Federal Courts have established guiding principles to be balanced when determining whether a receivership stay should be lifted. These principles should have equal application to state receivership cases. The balancing test involves consideration of the following:

"(1) [W]hether refusing to lift the stay genuinely preserves the status quo or whether the moving party will suffer substantial injury if not permitted to proceed; (2) the time in the course of the receivership at which the motion for relief from the stay is made; and (3) the merit of the moving party's underlying claim." *Wencke II*, 742 F.2d at 1231.

*U.S. v. Acorn Technology Fund*, *supra*, 429 F.3d at 443.

The Court explained the rationale behind this balancing test:

Given how rare non-bankruptcy receiverships are, it is not surprising that we have not yet faced this exact issue [footnote omitted] or that few

courts around the country have done so. The purposes of a receivership are varied, but the purpose of imposing a stay of litigation is clear. A receiver must be given a chance to do the important job of marshaling and untangling a company's assets without being forced into court by every investor or claimant. Nevertheless, an appropriate escape valve, which allows potential litigants to petition the court for permission to sue, is necessary so that litigants are not denied a day in court during a lengthy stay.

*U.S. v. Acorn Technology Fund, supra*, 429 F.3d at 443.

While the issue in *Acorn* involved lifting a receivership stay in order to sue the Receiver, there is no sound reason for the analysis to differ where a claimant is seeking to enforce a garnishment judgment against the Receiver. As to the first factor in the balancing test (regarding substantial injury), the Court explained:

A district court should give appropriately substantial weight to the receiver's need to proceed unhindered by litigation, and the very real danger of litigation expenses diminishing the receivership estate. At the same time, we agree with the *Wencke* courts that the interests of litigants also need to be considered. Far into a receivership, if a litigant demonstrates that harm will result from not being able to pursue a colorably meritorious claim, we do not see why a receiver should continue to be protected from suit. *Cf. Wencke II*, 742 F.2d at 1232 (reversing the district court's refusal to lift the stay, seven years into the receivership when the receiver was about to distribute assets and thereby disturb the status quo of the estate). On the other hand, very early in a receivership even the most meritorious claims might fail to justify lifting a stay given the possible disruption of the receiver's duties.

*U.S. v. Acorn Technology Fund, supra*, 429 F.3d at 443-444.

There is nothing in the record from the trial court, in this matter, that demonstrated any harm would result if the Appellees were not permitted to enforce their garnishment judgment so early in the receivership proceeding.

Even if the Appellees were legally entitled to a priority, over all other claimants, the timing of their demand for immediate payment from the receivership assets was premature:

What is *not* sufficient is a clear attempt by the [claimants] to withdraw funds from the receivership estate before the receiver is ready to distribute funds to *all* creditors. Not being allowed the first bite at the apple is not the kind of substantial injury we will recognize under the first prong of *Wencke*.

We will next address the second *Wencke* factor, the "time in the course of the receivership at which the motion for relief from the stay is made." *Wencke II*, 742 F.2d at 1231. . . . As we have already said, the very purpose of a receiver is to collect and disentangle a receivership estate's assets, including debts owed to it. In carrying out that purpose, the receiver simply does not consent to the bringing of a counterclaim by every debtor.

When the [claimants] first asked the District Court to lift the stay, the receivership had been in place for only ten months. It has now been in effect for 30-36 months. We are reluctant to set a clear cut-off date after which a stay should be presumptively lifted. The second *Wencke* prong is inherently case-specific, and of course, merely one of three linked considerations. The *Wencke II* court lifted a stay after seven years, but focused primarily on the fact that no new facts had been discovered in six years, and that the receiver was ready to distribute the assets. 742 F.2d at 1232. The *Wencke I* court had refused to lift the same stay after a mere two years. *Wencke I*, 622 F.2d at 1374; *see also ESIC Capital*, 685 F.Supp. at 485 ("[T]his motion comes at a fairly youthful age of the receivership--two years since its inception."). The Ninth Circuit in *Universal Financial* denied a motion to lift a four-year-old stay where "material facts continue to come to light." 760 F.2d at 1039. In this case, where the alleged fraud encompassed many individuals and companies, we cannot say that the timing factor tips in the [claimants'] favor. *See 3R Bancorp*, 2005 U.S. Dist. LEXIS 12503, at \*9.

Upon consideration of all three *Wencke* factors, even though the [claimants'] proposed claims may have merit, the other factors do not weigh in favor of allowing them to assert these claims at the present time. While it is true that "[t]he receivership cannot be protected from suit forever," *Wencke II*, 742 F.2d at 1231, we find that the Barracks have not carried their

burden of proving that the stay should be lifted.

*U.S. v. Acorn Technology Fund, supra*, 429 F.3d at 449-450.

The receivership proceeding, in the instant matter, was only *six months old* at the time the Superior Court ordered the stay to be lifted so that the Appellees' could enforce their garnishment judgment against the receivership assets of Trend Management. This left insufficient time for the Receiver to be able to determine such things as whether Trend Management actually had *any* monies belonging to it upon which the garnishment judgment could be enforced.<sup>47</sup> Once the receivership process has progressed (and possibly not until all claims have been filed and analyzed), the Receiver should have sufficient information to determine if the funds held by Trend Management are held in constructive trust for the benefit of all defrauded victims and, therefore, do not belong to Trend Management, or if there are monies available for distribution that are not subject to a constructive trust (or other competing interests).<sup>48</sup>

In any event, there was no legal basis for allowing the Appellees to "trump" all other victims' claims and move to the front of the line so that they would receive a distribution of receivership assets long before any other victims. Under a

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<sup>47</sup> See, Appeal Index No. 62, ("Response to Rule 60(C)(1) Motion . . . ", 2:17-18) where the Receiver argued: "[t]he stay order gives the Receiver time to sort out claims and make a reasoned recommendation on the distribution of assets."

<sup>48</sup> See, *Burch & Cracchiolo, P.A. v. Pugliani, supra.*

balancing of the foregoing factors, the Court abused its discretion in lifting the automatic stay.

**IV. Conclusion**

This Court should reverse the "Order to Enforce Judgment Against Garnishee Trend Management Group, Inc." If the Appellees wish to share in the receivership estate with all other investor-victims they may do so by filing a claim in the claims process once a claims process has been established, and approved, by the Receivership Court. (During that process, if the Receiver recommends to the Receivership Court that the Appellees not be treated differently from other investors, and the Appellees believe that is inequitable, they can object to the Receiver's recommendation. At that point, the Court may consider the claims of all victims in order to make a proper determination regarding the equitable treatment of the Appellees in light of all the facts provided by each claimant including any other claimants who also may seek preferential treatment.)

Respectfully submitted this 24<sup>th</sup> day of September, 2007.

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## APPENDIX

Arizona Revised Statutes Annotated Currentness

Title 44. Trade and Commerce

▣Chapter 12. Sales of Securities (Refs & Annos)

▣Article 4. Sale of Securities (Refs & Annos)

➔§ 44-1841. **Sale of unregistered securities prohibited; classification**

A. It is unlawful to sell or offer for sale within or from this state any securities unless the securities have been registered pursuant to article 6 or 7 of this chapter [FN1] or are federal covered securities if the securities comply with § 44-1843.02 or chapter 13, article 12 of this title. [FN2]

B. A person violating this section is guilty of a class 4 felony.

CREDIT(S)

Amended by Laws 1978, Ch. 186, § 8; Laws 1978, Ch. 201, § 825, eff. Oct. 1, 1978; Laws 1989, Ch. 174, § 1; Laws 1991, Ch. 262, § 3, eff. June 18, 1991; Laws 1997, Ch. 240, § 4; Laws 2000, Ch. 108, § 8.

[FN1] Sections 44-1861 et seq., 44-1871 et seq.

[FN2] Section 44-3321 et seq.

Arizona Revised Statutes Annotated Currentness

Title 44. Trade and Commerce

▣Chapter 12. Sales of Securities (Refs & Annos)

▣Article 4. Sale of Securities (Refs & Annos)

➔§ 44-1842. **Transactions by unregistered dealers and salesmen prohibited; classification**

A. It is unlawful for any dealer to sell or purchase or offer to sell or buy any securities, or for any salesman to sell or offer for sale any securities within or from this state unless the dealer or salesman is registered as such pursuant to the provisions of article 9 [FN1] of this chapter.

B. A person violating this section is guilty of a class 4 felony.

#### CREDIT(S)

Amended by Laws 1978, Ch. 201, § 826, eff. Oct. 1, 1978.

[FN1] Section 44-1941 et seq.

Arizona Revised Statutes Annotated Currentness

Title 44. Trade and Commerce

▣ Chapter 12. Sales of Securities (Refs & Annos)

▣ Article 13. Fraudulent Practices (Refs & Annos)

➔ **§ 44-1991. Fraud in purchase or sale of securities**

A. It is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities, including securities exempted under § 44-1843 or 44-1843.01 and including transactions exempted under § 44-1844, 44-1845 or 44-1850, directly or indirectly to do any of the following:

1. Employ any device, scheme or artifice to defraud.

2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the

circumstances under which they were made, not misleading.

3. Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

**B.** In a private action brought pursuant to subsection A, paragraph 2 of this section or § 44-1992, if the person who offered or sold the security proves that any portion or all of the amount recoverable under subsection A, paragraph 2 of this section or § 44-1992 represents an amount other than the depreciation in value of the subject security resulting from the part of the prospectus or oral communication, with respect to which the liability of the person is asserted, not being true or omitting to state a material fact required to be stated or necessary to make the statement not misleading, then the amount shall not be recoverable. This subsection does not apply to any actions based on allegations of activities constituting dishonest or unethical practices in the securities industry.

CREDIT(S)

Amended by Laws 1978, Ch. 186, § 16; Laws 1996, Ch. 197, § 3; Laws 2000, Ch. 108, § 37; Laws 2001, Ch. 7, § 10.

## CERTIFICATE OF COMPLIANCE

Pursuant to Rule 14, Ariz. R. Civ. App. Proc., I certify that the attached brief uses proportionately spaced type of 14 points or more, is double spaced using a roman font and contains 5,062 words. The word count was provided by the word processing system used to prepare the brief.

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**CERTIFICATE OF SERVICE**

The undersigned, on behalf of the Appellant-Receiver and his attorneys,  
hereby certify that two copies of Appellant-Receiver's Opening Brief were served  
this 24th day of September, 2007, by first class mail to:

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