UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, - against - SPIRO GERMENIS, ORACLE SERVICES INC., and ORACLE EVOLUTION, LLC, Defendants, ORACLE E FUND, LP, ORACLE J FUND, LP, and ORACLE EVOLUTION CAPITAL, LLC, Relief Defendants.	06 Civ. 6153 (LDW / ETB)

MEMORANDUM OF LAW OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF MOTION FOR APPROVAL OF DISTRIBUTION PLAN

SECURITIES AND EXCHANGE COMMISSION
3 World Financial Center, Room 400
New York, New York 10281-1022
Tel.: (212) 336-0080
Fax: (212) 336-1324
E-mail: brodyt@sec.gov

Todd D. Brody
John J. Graubard
Dina Levy
Attorneys for Plaintiff

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Regulations

PRELIMINARY STATEMENT

Plaintiff Securities and Exchange Commission ("Commission"), through its attorneys, moves the Court to authorize the pro rata distribution, to the defrauded investors in this action, of the approximate $240,000 collected by the Commission in this action. A pro rata distribution is favored because it distributes the recovery among the investors in proportion to their losses.

STATEMENT OF FACTS

In October 2006, Spiro Germenis ("Germenis"), the principal of Oracle Services, Inc. ("Services"), a New York State registered investment advisor, disappeared. (Compl. ¶ 1(Dkt. 1)). The Commission's investigation revealed that over a period of years Germenis had raised at least $9,083,295 from at least 27 investors. (Johnson Decl. at ¶ 3.) Germenis purported to run several different investment vehicles, including the Oracle E Fund, LP (the "E Fund"), the Oracle J Fund, LP (the "J Fund"), and individual investment accounts. (*Id.* at ¶¶ 2-4.) In fact, however, Germenis ran a Ponzi scheme and stole the funds that the unwitting investors entrusted to him. (*Id.*) Little of the investor money was actually invested. (*Id.* at ¶ 4.) And all of the investors, no matter in which vehicle they believed their money was invested, were treated the same. The 27 known investors collectively suffered losses of approximately $6.5 million. (*Id.* at ¶¶ 3–5.)

The Commission brought this action on November 16, 2006, against defendants Germenis, Services, and Oracle Evolution, LLC ("Evolution") (collectively the "Defendants") and relief defendants the E Fund, the J Fund, and Oracle Evolution Capital, LLC ("Capital") (collectively the "Relief Defendants"). (Compl.) In the Complaint, the Commission alleged that the Defendants violated various provisions of the federal securities laws: (1) Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a); (2) Section 10(b) of the Securities

Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; and (3) Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C. §§ 80b-6(1) and 80b-6(2).

None of the Defendants or Relief Defendants answered or otherwise appeared in this action. On October 2, 2008, the Court entered an Amended Final Judgment by Default (the "Final Judgment") (Dkt. No. 58). The Final Judgment, in part, ordered the Defendants and the Relief Defendants, jointly and severally, to disgorge the amount of $6,500,000 in ill-gotten gains and $1,205,249.83 in prejudgment interest, for a total of $7,705,249.83. The Final Judgment required that these amounts be deposited in the Court Registry Investment System ("CRIS"). The Final Judgment imposed a civil penalty of $480,000 each on Germenis and on Evolution, and a $240,000 civil penalty on Services, which were also to be deposited in the CRIS.

Since entry of the Final Judgment, the Commission has sought to collect the amounts due from the Defendants and the Relief Defendants. (Johnson Decl. ¶ 14-15.) To date, the Commission has collected approximately $229,000 from the Defendants and the Relief Defendants.[1] (*Id.* at ¶¶ 11-12.) Almost all of the funds recovered by the Commission were in a third party administrator account set up by Germenis for the J Fund. (*Id.* at ¶¶ 5, 11.)

Included in this was an investment of $200,000 made by Investor 19.[2] (*Id.* at ¶ 11.) From the records obtained by the Commission, it appears that Germenis comingled the amounts received from Investor 19 with slight trading profits that Germenis had made on the rare occasions he had actually made investments with investor funds. (*Id.* at ¶¶ 11.)

---

1 The amount in the CRIS account is different because of interest earned and the amounts withdrawn to pay the Tax Administrator and tax obligations.

2 The Commission is redacting the name and address of each investor from these papers. If the Court approves the proposed Scheduling Order, the Commission will file this information under seal with the Court.

Having searched for additional assets, the Commission believes that it will not likely collect additional funds from the Defendants or from the Relief Defendants.[3] (Johnson Decl. ¶¶ 14–16.)

THE PROPOSED DISTRIBITION PLAN

The Commission proposes to distribute the net funds on deposit in CRIS, after provision for the payment of taxes and the fees and expenses of the Tax Administrator, pro rata to investors based on their net loss. The proposed Distribution Plan provides that any funds remaining after the distribution to the Eligible Investors and the payment of taxes and the Tax Administrator be paid to the Commission and remitted to the United States Treasury.

ARGUMENT

District courts have broad discretion to create remedies for violations arising from the Securities Exchange Act. S*ee, e.g., Official Committee of Unsecured Creditors of Worldcom, Inc. v. Securities and Exchange Commission*, 467 F.3d 73, 81 (2d Cir. 2006); *SEC v. Malek,* No. 09 Civ. 3583, slip op. (2d Cir. Oct. 25, 2010). This broad discretion includes how to distribute any money recovered from the defendants. *SEC v. Fishbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997) ("[I]t remains within the court's discretion to determine how and to whom the money will be distributed."); *Worldcom*, 467 F.3d at 81. Notwithstanding this discretion, the Second Circuit has stated that given the Commission's authority to enforce the securities laws, it defers to the agency's "experience and expertise" in determining how disgorged profits should be distributed. *Worldcom*, 467 F.3d at 82; *see also Byers*, 637 F. Supp.2d at 175 ("The Commission's judgment is entitled to deference from this Court."). "Unless a consent decree specifically provides

[3] Germenis is a fugitive whose whereabouts are unknown. The other Defendants and Relief Defendants are entities that were solely owned, operated, and controlled by Germenis and which have no known assets. (Johnson Decl. ¶ 15.) A criminal action against Germenis is pending in this Court. *United States v. Germenis*, 07 MJ 1047 (RLM) (E.D.N.Y.).

otherwise, once the district court satisfied itself that the distribution of proceeds in a proposed Commission disgorgement plan is fair and reasonable, its review is at an end." *Worldcom*, 467 F.3d at 82; *Byers*, 637 F. Supp.2d at 174 ("The court has the authority to approve any plan provided it is 'fair and reasonable.'").

The Commission has made a determination in this case that a pro rata distribution is the most equitable and reasonable method of compensating the victims of this fraud, particularly in light of the fact that so little of the misappropriated money has been recovered. In addition, Germenis ran a Ponzi scheme, and "the use of a *pro rata* distribution has been deemed especially appropriate for fraud victims of a 'Ponzi scheme,' . . . in which 'earlier investors' returns are generated by the influx of fresh capital from unwitting newcomers rather than through legitimate investment activity." *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 89 (2d Cir. 2002)(quoting *United States v. Durham*, 86 F.3d 70, 72 (5^{th} Cir. 2001)[4]

While all of the defrauded investors will have an opportunity to respond to the Commission's proposed plan, the Commission wants to bring to the Court's immediate attention two issues, which the Commission considered in the creation of the proposed distribution plan. First, the Commission anticipates that Investor 19 will claim that he can "trace" $200,000 of the recovered amount to his own investment. We believe that Investor 19 will argue that this $200,000 should be set aside for his exclusive use. Second, because the investors purportedly were in different investment vehicles, there is an issue as to whether the E Fund, the J Fund, and

[4] In light of the pro se status of the investors, the Commission will, upon request, provide copies of the legal materials cited in this Memorandum to any investor who requests them.

the individual accounts should be treated separately or merged for the calculation of distribution.[5]

The Commission respectfully submits that the Court should apply the equitable maxim that "equality is equity." *Cunningham v. Brown*, 265 U.S. 1, 13 (1924); *see also SEC v. Malek*, No. 09 Civ. 3583, slip op. at 9; *In re Bernard L. Madoff Inv. Securities LLC*, 424 B.R. 122, 142 (Bank

r. S.D.N.Y. 2010). The application of this maxim here would result in the limited funds collected by the Commission being pooled and distributed to all of the defrauded investors regardless of what vehicle they believed they invested in or whether they can trace their funds to the collected amount. Indeed, if the Court were to allow a single investor to take the lion's share of the funds for himself, the remaining funds would be insufficient to justify any distribution to the other investors. In that event, the Commission would then request that the Court order the remaining funds, after payment of taxes and the Tax Administrator, be paid to the United States Treasury.

In the *Worldcom* case, the Court of Appeals stated, "When funds are limited, hard choices must be made." 467 F.3d at 84. In this case, the available funds are extremely limited and do not come close to meeting the $6.5 million stolen from investors. While the Commission understands that pursuant to its proposed distribution plan none of the investors will be made whole, all of the defrauded investors will receive back at least some of their investment. The Commission believes, therefore, that a pro rata distribution is equitable and reasonable.

I. Pro Rata Distributions Are Favored in Ponzi Scheme Cases

[5] We note, however, that some of the investors believed that they were investing in more than one of the investment vehicles offered by Germenis.

In numerous cases, courts in the Second Circuit and elsewhere have found that the most appropriate distribution plan in a Ponzi scheme case is a pro rata distribution.

In *Credit Bancorp*, 90 F.3d at 84, for example, the defendant solicited investors to deposit securities, which the defendant agreed to keep in segregated accounts for use in "riskless arbitrage" trading. Instead, however, the defendant comingled, pledged, and otherwise used these securities to pay off prior investors as well as to support its currency futures and options trading activities, which led to substantial losses. *Id.* The receiver in that case proposed to liquidate the remaining securities held by Credit Bancorp and to distribute the cash received for the securities pro rata to the defrauded investors and the district court agreed. *Id.* at 85-86. On appeal, the Second Circuit upheld the pro rata distribution of the remaining funds, endorsing the equitable authority of the district court to treat <u>all fraud victims alike</u>. The Second Circuit noted that :

> Courts have favored *pro rata* distribution of assets where, as here, the funds of the defrauded victims were comingled and where victims were similarly situated with respect to their relationships to the defrauders. . . .

290 F.3d at 88-89. The Second Circuit further noted that:

> [T]he use of a *pro rate* distribution has been deemed especially appropriate for fraud victims of a "Ponzi scheme" . . . [in which] whether at any given moment a particular customer's assets are traceable is "a result of the merely fortuitous fact that the defrauders spent the money of other victims first." [Citations omitted.]

290 F.3d at 89; *see also Malek,* slip op. at 8. As such, the Second Circuit found that it is irrelevant that one investor can trace his particular investment to the remaining funds.

This holding follows a line of cases starting with that involving the original scheme of Charles Ponzi. The United States Supreme Court there held that the "fiction" of tracing specific assets would be suspended where the receivership fund consisted of assets obtained from the latest victims, deeming it appropriate to distribute these to the entire class of those defrauded.

Cunningham v. Brown, 265 U.S. 1, 13 (1924). The Court ruled this to be "a case the circumstances of which call strongly for the principle that equality is equity. . . ." *Id.*

The use of a pro rata distribution in Ponzi scheme cases is well established. In *United States v. Dreier*, 682 F. Supp.2d 417, 422 (S.D.N.Y. 2010), the court approved a pro rata distribution plan, which even included a creditor who was not a Ponzi scheme victim. This creditor argued that he should be treated differently from the defrauded investors as his loss did not result from an investment with Dreier, but from Dreier's forging of his name on a settlement agreement. In rejecting the creditor's claim for special treatment, the court stated:

> There is nothing *per se* unfair about a *pro rata* distribution; the Second Circuit has endorsed this approach as particularly appropriate for frauds like Dreier's involving a Ponzi scheme or the comingling of similarly situated victims' assets. It is clear from the responses that Gardi is not the only "client" victim of Dreier's frauds or to whom Dreier owed fiduciary duties, and each case doubtless has its own nuances.

Id. Moreover, the Court noted that a Ponzi scheme "is like an earthquake that savages its victims at random and is followed by a series of aftershocks that destroys still further assets. Any alternative to the *pro rata* approach would entail a costly and extensive inquiry into the circumstances of each victim's loss, which would likely devolve into a war of recriminations, to the detriment of all concerned." *Id.* at 422-3.

In *Byers*, 637 F. Supp.2d at 176, the court similarly adopted the pro rata distribution model and rejected the attempts by certain objectors who sought to "assert a superior claim to the receivership *res* so that they can recoup their entire investment." In particular, the Court ruled that the tracing argument was simply inequitable.

> The alternatives to pro rata distribution that have been proposed would create unfair results by rewarding certain investors over others based on arbitrary factors. *Cf. Credit Bancorp,* 290 F.3d at 89 (noting that, in Ponzi schemes, "whether at any given moment a particular customer's assets are traceable is 'a result of the merely fortuitous fact that the defrauders spent the money of the

> other victims first'") (quoting *United States v. Durham,* 86 F.3d at 72). Tracing analysis – proposed by a number of objectors – in particular has been almost universally rejected by courts as inequitable. *See, e.g., id.* (rejecting tracing as inequitable); *United States v. 13328 & 13324 State Highway 75 N.*, 89 F.3d 551, 553 (9th Cir. 1996) (holding that tracing would "frustrate equity"); *Durham,* 86 F.3d at 73 (holding that "following the tracing principle would be inequitable"); *Securities and Exchange Commission v. Elliott,* 953 F.2d 1560, 1569 (11th Cir.1992) (rejecting tracing as inequitable). The Receiver considered and rejected tracing, based on equitable grounds and on the recommendation of his accountants that tracing would be "difficult, time-consuming, and expensive-and the ultimate benefit to the estate would be minimal at best." (*Id.* at 8).

637 F. Supp.2d at 177.[6]

In this case, Germenis ran a classic Ponzi scheme. He used the funds from later investors in part to pay his earlier investors, to keep his fraud going, and in part to add to his ill-gotten gains. As with any Ponzi scheme, it eventually would collapse, and when it did there would be insufficient funds on hand to pay all of the defrauded investors. To adopt any distribution other

---

[6] See also *SEC v. Basic Energy & Affiliated Resources, Inc.*, 273 F.3d 657, 668 (6th Cir. 2001) (approving district court's plan to treat investors "in the same manner" as others because "[a]s the Supreme Court noted in the original Ponzi case, such cases 'call strongly for the principle that equality is equity'")(citing *Cunningham*, 265 U.S. at 13); *SEC v. Commission v. Forex Asset Management, LLC*, 242 F.3d 325, 332 (5th Cir. 2001) (affirming pro rata distribution even though some investor funds were not commingled); *Commodities Futures Trading Commission v. Topworth Int'l Ltd.*, 205 F.3d 1107, 1110 (9th Cir. 1999) (approving receiver's plan that proposed combining multiple entities into one fund "[b]ecause each entity appeared to be the alter ego of the other"); *13328 and 13324 State Highway 75 North*, 89 F.3d at 553 (in upholding pro rata distribution to victims, stating, "This Court believes that where, as here, the struggle over the res derived from fraudulent conduct is between innocent parties, tracing should not and will not apply."); *United States v. Vanguard Investment Co.*, 6 F.3d 222 (4th Cir. 1993) (approving pro rata distribution although some investors could trace their funds as all investors shared same equitable position); *Durham*, 86 F. 3d at 73 (affirming pro rata distribution even though money could be traced to particular claimants); *SEC v. Elliott*, 953 F.2d, 1560, 1570 (11th Cir. 1992)(affirming district court's decision to disallow tracing in Ponzi-scheme, holding that all former securities owners "occupied the same legal position" and thus some should not be preferred over others); *In re Trending Cycles for Commodities, Inc.*, 27 B.R. 709, 710-11 (Bankr. S.D. Fla. 1983) (in a "pool operation, [in which] there is no record of any specifically identifiable property held for any specific customer," court approves distribution plan "based upon an amount equal to the total out-of-pocket deposit made by a customer minus withdrawals with respect to such contracts" under a rescission/restitution theory) (citations omitted).

than a pro rata method would be to try to distinguish between the victims of a common fraudulent scheme based solely on happenstance. Therefore, the pro rata distribution proposed by the Commission in the Distribution Plan is the prima facie appropriate method. And the Court should reject any argument by Investor 19 or any other investor that he/she should be treated differently because his/her investment specifically can be traced to the recovered funds.

II. The Funds Were Comingled and the Investors Are Similarly Situated

As described in *Credit Bancorp* and the other cases cited above, there are two factual predicates for a pro rata distribution: (1) the funds have been comingled; and (2) the investors are similarly situated. Both factual predicates are present here.

A. Comingling of Assets

In the *Byers* case, the court discussed the extent of commingling necessary to satisfy this requirement. The court observed that several other courts had held that, because money is fungible, "*any* commingling is enough to warrant treating all the funds as tainted." 637 F. Supp.2d at 177 (emphasis in original)(citing *United States v. Garcia*, 37 F.3d 1359, 1365-6 (9th Cir. 1994), and *SEC v. Better Life Club of Am., Inc.*, 995 F. Supp. 167 (D.D.C. 1998), and *Commodities Futures Trading Commission v. Eustace*, No. 05 CV 2973, 2008 U.S. Dist. LEXIS 11810 at *22 (E.D. Pa. Feb. 15, 2008)(approving pro rata distribution even where commingling was "not necessarily systematic")).

As described in the Johnson Declaration, Germenis extensively comingled the funds of the investors in the E Fund, the J Fund, and the individual accounts. With slight exceptions, money, upon being received by Germenis from investors, was never invested, but rather was deposited into various bank or brokerage accounts controlled by Germenis, and then transferred by Germenis into his personal bank accounts. (Johnson Decl. ¶ 4.) As an example, on April 28, 2006, Germenis deposited $130,864 from Investor 2 into a bank account in the name of the E Fund. (*Id.* at ¶ 8.) Shortly thereafter, he transferred approximately $585,000 from Investors 1 and 13 into that same E Fund bank account, notwithstanding that those latter two investors had engaged Germenis to manage individual investment accounts. (*Id.*) Subsequently, Germenis transferred $562,000 from that E Fund account to a separate bank account held in the name of the J Fund. (*Id.*) That J Fund account had previously received approximately $45,000 from J Fund investors 7 and 16. (*Id.*) These transfers demonstrate extensive commingling between E Fund, J Fund, and individual accounts. On numerous other occasions, Germenis transferred money back and forth between the J and E Fund accounts described above. (*Id.* at ¶¶ 9-10.) In addition, the J Fund Shoreline brokerage account in which Investor 19's $200,000 was placed, already had approximately $27,000 in profits and interest derived from some of the rare investments Germenis actually made with investor funds. (*Id.* at ¶ 11.) Consequently, even Investor 19's money was commingled with money belonging to other investors. It is just happenstance that Germenis did not have time to misappropriate the $227,000 in the Shoreline brokerage account.

B. <u>Similarly Situated Investors</u>

In addition to the fact that investor money was commingled, all of the investors were similarly situated. They were all treated essentially the same, both with respect to the representations made to them by Germenis and the misappropriation of their funds by Germenis.

The Second Circuit has held that for parties to be similarly situated, "their circumstances need not be identical, but there should be a reasonably close resemblance of facts and circumstances." *Malek,* slip op. at 9 *(quoting Lizardo v. Denny's, Inc.*, 270 F.3d 94, 101 (2d Cir. 2001)); *see also McGuinness v. Lincoln Hall*, 263 F.3d 49, 54 (2d Cir. 2001)(similarly situated does not mean identical but rather similar in all material respects). In *Byers*, 637 F. Supp.2d at 180, the court noted the following factors, among others, as relevant to a finding that the victims were similarly situated: the role of the defendant as manager of all of the investment in exchange for a management fee and similarities among the offering materials provided to investors.

It is clear that there was a close resemblance of facts and circumstances with respect to the defrauded investors no matter in which vehicle they had intended to invest. The investors shared the same relationship with Germenis. Germenis solicited their investments, handled those investments, interacted with all of clients about their investments (including giving them false performance figures) and misappropriated their money. (Johnson Decl. ¶ 6.) With respect to the E Fund and the J Fund, Germenis provided very similar offering memoranda to investors. (Compl. ¶¶ 21-27; Johnson Decl. ¶ 8.) Investors who retained Germenis as an investment advisor and who believed their money was going into separately managed accounts received similar representations. (Compl. ¶¶ 28-33; Johnson Decl. ¶ 8.) The investment strategy – primarily publicly-traded equity securities – was the same. Moreover, once these investors turned their money or previously-established investments accounts over to Germenis, he misappropriated their money in the same way. Rather than investing their assets, he uniformly spent down the funds that they had turned over to him, making withdrawals from these funds to pay for his lavish personal expenses or making redemptions to investors. And whether he was misappropriating money from the E Fund, from the J Fund, or from individual investor accounts, he did it the same way: by moving that money through various accounts that he controlled at banks and other institutions. (Compl. ¶ 34; Johnson Decl. ¶¶ 8-10.) Germenis did not distinguish among them when he took their funds for his personal benefit.

III. The Recovered Funds Should Be Pooled

In addition to the fact that there should be a pro rata distribution, for the reasons set forth above, the recovered money – no matter the source – should be pooled. In addition to the approximately $227,000 remaining in the Shoreline account, the Commission located a total of about $2,100 in other accounts Germenis managed in connection with his purported investment operations. (Johnson Decl. ¶ 12.) All of Germenis's investors were deceived by the same fraud. All of these investors contributed their funds to the same fraudulent scheme. Therefore, it is fair, just, and equitable that all investors share pro rata in the distribution of whatever funds remain. *See SEC v. Forex Asset Management LLC*, 242 F.3d 325, 331 (5th Cir. 2001)(even though one investor's funds were placed in a separate account, the court deemed it appropriate to aggregate this with the other funds recovered for a pro rate distribution to all defrauded parties)(citing *Durham,* 86 F.3d at 71-72); *see also Topworth Intern., Ltd.*, 205 F.3d 1107; *SEC v. Infinity Group Co.*, 226 Fed. Appx. 217 (3d Cir. 2007); *SEC v. George*, 426 F.3d 786 (6th Cir. 2005).

CONCLUSION

For the reasons set forth above, the Court should approve the Commission's Distribution Plan and direct that the funds be distributed pro rata to the defrauded investors.

Dated: New York, New York
December 2, 2010

/s/

Todd D. Brody
John J. Graubard
Dina Levy
Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION
3 World Financial Center, Room 400
New York, New York 10281-1022
Tel.: (212) 336-0080
Fax: (212) 336-1324
E-mail: brodyt@sec.gov