

COMMISSION AUTHORIZED**88-6294**

Nos. 88-6294, 88-6296, 88-6298, 88-6300, 88-6302 and 88-6304

**IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

**DENNIS B. LEVINE a/k/a MR. DIAMOND,
INTERNATIONAL GOLD, INC., DIAMOND HOLDINGS, S.A.
and BERNHARD MEIER,**

Defendants,

**ARDEN WAY ASSOCIATES, et al., UNITED STATES OF AMERICA,
ROBERT M. WILKIS, DENNIS B. LEVINE, and NEW YORK
STATE DEPARTMENT OF TAXATION AND FINANCE,**

Appellants.

**On Appeal From the United States District Court
for the Southern District of New York**

BRIEF FOR THE FEDERAL TRADE COMMISSION AS AMICUS CURIAE

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TABLE OF CONTENTS

	<u>Page</u>
TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	ii
STATEMENT OF THE ISSUES.	1
INTEREST OF THE FEDERAL TRADE COMMISSION	2
STATEMENT OF THE CASE.	6
SUMMARY OF ARGUMENT.	8
ARGUMENT	9
I. THE DISTRICT COURT'S IMPOSITION OF A CONSTRUCTIVE TRUST IS WITHIN ITS STATUTORY AUTHORITY TO FORMULATE EQUITABLE REMEDIES FOR VIOLATIONS OF FEDERAL SECURITIES LAWS.	9
II. THE COURT'S AUTHORITY TO IMPOSE A CONSTRUCTIVE TRUST CANNOT BE THWARTED BY THE FORUM STATE'S CONSTRUCTIVE TRUST DOCTRINE	11
III. A CONSTRUCTIVE TRUST DEFEATS IRS PRIORITY CLAIMS	15
CONCLUSION	19

TABLE OF AUTHORITIES

	<u>Page</u>
<u>CASES:</u>	
<u>Alsco-Harvard Fraud Litigation,</u> 523 F. Supp. 790 (D.D.C. 1981)	15
<u>American Serv. Co. v. Henderson,</u> 120 F.2d 525 (4th Cir. 1941)	15
<u>Aquilino v. United States,</u> 363 U.S. 509 (1960).	15, 16
<u>Assoc. Brick Mason Contractors, Inc. v. Harrington,</u> 820 F.2d 31 (2d Cir. 1987)	12
<u>Atlas, Inc. v. United States,</u> 459 F. Supp. 1000 (D. N.D. 1978)	16
<u>Beatty v. Guggenheim Exploration Co.,</u> 225 N.Y. 380, 122 N.E. 378 (1919).	11
<u>Burks v. Lasker,</u> 441 U.S. 471 (1979)	13, 17
<u>Chicago Board of Trade v. Johnson,</u> 264 U.S. 1 (1924).	14
<u>CFTC v. Co Petro Marketing Group, Inc.,</u> 680 F.2d 573 (9th Cir. 1982)	10
<u>CFTC v. Hunt,</u> 591 F.2d 1211 (6th Cir.), <u>cert. denied,</u> 442 U.S. 921 (1979).	10
<u>CFTC v. Muller,</u> 570 F.2d 1296 (5th Cir. 1978).	10
<u>Dennis v. United States,</u> 372 F. Supp. 563 (E.D. Va. 1974).	16
<u>FTC v. Alaska Land Leasing, Inc.,</u> No. 84-5416 (C.D. Cal. July 23, 1984).	3
<u>FTC v. Alaska Land Leasing, Inc.,</u> 5 Trade Reg. Rep. (CCH) ¶ 22,459 (July 14, 1987).	4

TABLE OF AUTHORITIES
CONT'D

	<u>Page</u>
<u>CASES:</u>	
<u>FTC v. Austin Galleries, Inc., 1988-2 Trade Cas. (CCH) ¶ 68,340 (N.D. Ill. 1988)</u>	3
<u>FTC v. Evans Products Co., 5 Trade Reg. Rep. (CCH) ¶ 22,480 (Oct. 22, 1987)</u>	4
<u>FTC v. H.N. Singer, Inc., 668 F.2d 1107 (9th Cir. 1982)</u>	3, 10
<u>FTC v. Leland Indus., Inc., (1983-1987 Transfer Binder) Trade Reg. Rep. (CCH) ¶ 22,297 (C.D. Cal. Oct. 11, 1985)</u>	4
<u>FTC v. Rainbow Enzymes, Inc., No. Civ-87-1522 (D. Ariz. 1988)</u>	5
<u>FTC v. Rare Coin Galleries of America, Inc., 1986-2 Trade Cas. (CCH) ¶ 67,338 (D. Mass. 1986)</u>	3, 10
<u>FTC v. Rare Coins of Georgia, 5 Trade Reg. Rep. (CCH) ¶ 22,309 (N.D. Ga. Dec. 5, 1988)</u>	4
<u>FTC v. U.S. Oil & Gas Corp., 748 F.2d 1431 (11th Cir. 1984)</u>	2, 9, 10
<u>FTC v. U.S. Oil & Gas Corp., No. 83-1702-Civ-Hoeveler (S.D. Fla. July 10, 1987)</u>	4, 5
<u>FTC v. World Travel Vacations Brokers, Inc., 861 F.2d 1020 (7th Cir. 1988)</u>	2
<u>FTC v. Worldwide Factors, Ltd., No. Civ-S-88--293-RDF (LRL) (D. Nev. May 19, 1988)</u>	5
<u>First National Bank of Cartersville v. Hill, 412 F. Supp. 422 (N.D. Ga. 1976)</u>	16
<u>Hecht Co. v. Bowles, 321 U.S. 321 (1944)</u>	15
<u>Holmberg v. Armbrecht, 327 U.S. 392 (1946)</u>	12, 13

TABLE OF AUTHORITIES
CONT'D

	<u>Page</u>
<u>CASES:</u>	
<u>In re Bevill, Bresler & Schulman, Inc.,</u> Civ. No. 85-2224 (DRD) (D.N.J. Jan. 10, 1989) . . .	14
<u>In re Independent Clearing House Co.,</u> 41 B.R. 985 (Bankr. D. Utah 1984), aff'd in part, rev'd in part sub nom. <u>In re Universal Clearing House Co.,</u> 62 B.R. 118 (D. Utah 1986)	15
<u>In re Johnson,</u> 80 B.R. 791 (Bankr. E.D. Va. 1987)	14
<u>In re North American Coin & Currency, Ltd.,</u> 767 F.2d 1573 (9th Cir. 1985).	14
<u>In re Teltronics, Ltd,</u> 649 F.2d 1236 (7th Cir. 1981).	14
<u>Morgan v. Koch,</u> 419 F.2d 993 (7th Cir. 1969).	12
<u>Niagara Mohawk Power v. Bankers Trust Co.</u> <u>of Albany,</u> 791 F.2d 242 (2d Cir. 1986)	14
<u>Porter v. Warner Holding Co.,</u> 328 U.S. 395 (1946).	10
<u>Reliance Insurance Co. v. Brown,</u> 40 B.R. 214 (W.D. Mo. 1984).	18
<u>Republic of Philippines v. Marcos,</u> 806 F.2d 344 (2d Cir. 1986).	11, 14
<u>Robinson v. Pan American World Airways, Inc.,</u> 777 F.2d 84 (2d Cir. 1985)	12
<u>SEC v. Capital Counsellors, Inc.,</u> 332 F. Supp. 291 (S.D.N.Y. 1971)	10
<u>SEC v. Certain Unknown Purchasers,</u> 817 F.2d 1018 (2d Cir. 1987)	9
<u>SEC v. Levine,</u> 689 F. Supp. 317 (S.D.N.Y. 1988).	passim

TABLE OF AUTHORITIES
CONT'D

	<u>Page</u>
<u>CASES:</u>	
<u>SEC v. R.J. Allen & Associates, Inc.</u> , 386 F. Supp. 866 (S.D. Fla. 1974)	10
<u>SEC v. Texas Gulf Sulphur Co.</u> , 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971)	10
<u>Sperry v. Barggren</u> , 523 F.2d 708 523 F.2d 708 (7th Cir. 1975)	12
<u>Sprague v. Ticonic National Bank</u> , 307 U.S. 161 (1939)	13
<u>United States v. Fontana</u> , 528 F. Supp. 137 (S.D.N.Y. 1981)	16, 17, 18
 <u>STATUTES:</u>	
 Commodity Exchange Act:	
7 U.S.C. § 2	9
7 U.S.C. § 13a-1	9
 First Judiciary Act:	
1 Stat. 73	12
 Federal Trade Commission Act:	
§ 5(a), 15 U.S.C. § 45(a)	2
§ 13(b), 15 U.S.C. § 53(b)	passim
§ 19, 15 U.S.C. § 57b	3
 Internal Revenue Code:	
§ 6321, 26 U.S.C. § 6321	7, 8, 15
Investment Advisors Act (IAC)	13
Investment Company Act (ICA)	13

TABLE OF AUTHORITIES
CONT'D

Page

STATUTES CONT'D:

Securities and Exchange Act:

§ 10(b), 15 U.S.C. § 78j(b)	2, 6
§ 14(e), 15 U.S.C. § 78n(e)	2, 6

Securities Investor Protection Act (SIPA)	14
---	----

Rules and Regulations:

17 C.F.R. § 240.10b-5	6
17 C.F.R. § 240.14e-3	6

MISCELLANEOUS:

1 Pomeroy, Equity Jurisprudence (4th ed.) § 155	13
5 Scott, Trusts (3d ed.) § 462.4	18
Bogert, Trusts & Trustees (2d rev. ed.) § 472	18
D. Dobbs, Remedies § 4.3 (1973)	11

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STATEMENT OF THE ISSUES

1. Whether the district court, in imposing a constructive trust on defendants' ill-gotten gains for the benefit of defrauded investors, properly employed its equitable powers to remedy violations of the federal securities laws.

2. If the district court's imposition of a constructive trust was proper, whether the ill-gotten gains were thereby held free of federal tax liens.

INTEREST OF THE FEDERAL TRADE COMMISSION

The Federal Trade Commission ("FTC" or "Commission"), as amicus curiae, respectfully submits this brief pursuant to Rule 29 of the Federal Rules of Appellate Procedure. The FTC supports the position of the plaintiff-appellee, Securities and Exchange Commission ("SEC"), that the district court was correct in determining that illegal insider-trading profits, which had been disgorged into a receivership account following settlement of charges that the defendants had violated Sections 10(b) and 14(e) of the Securities and Exchange Act, 15 U.S.C. §§ 78j(b) and 78n(e), were held in constructive trust for the benefit of injured investors free of tax liens.¹

The FTC is charged by Congress, *inter alia*, with enforcement of Section 5(a) of the Federal Trade Commission Act ("FTC Act" or "Act"), 15 U.S.C. § 45(a), which prohibits "unfair or deceptive acts or practices in or affecting commerce." Under Section 13(b) of the Act, 15 U.S.C. § 53(b), the Commission is authorized to initiate federal district court proceedings to enjoin violations of the FTC Act and to secure such monetary equitable relief as may be appropriate in each case. See, *e.g.*, FTC v. World Travel Vacations Broker, Inc., 861 F.2d 1020, 1031 (7th Cir. 1988); FTC v. U.S. Oil & Gas Corp., 748 F.2d 1431, 1434

¹ The FTC expresses no opinion on any other issues raised in this appeal.

(11th Cir. 1984); FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1113 (9th Cir. 1982).²

Under Section 13(b), the FTC has filed numerous cases seeking to enjoin fraudulent and deceptive practices and to obtain monetary equitable relief to redress consumer injury. Typically, these cases have involved consumers who purchased investments such as land leases, rare coins, and art, in reliance on false or deceptive representations as to facts that were material to their decision to purchase. For example, in FTC v. Alaska Land Leasing, Inc., No. 84-5416 (C.D. Cal. July 23, 1984), consumers allegedly were told that the defendants' expert geologists had selected certain Alaskan lands as having high potential for the commercial recovery of oil and gas when, in fact, these geologists had determined that this land had little or no such potential. In FTC v. Rare Coins Galleries of America, Inc., 1986-2 Trade Cas. (CCH) ¶ 67,338 (D. Mass. 1986), defendants allegedly misrepresented the grade, value, and investment potential of rare coins, which were, in fact, worth only a fraction of what consumers paid for them. In FTC v. Austin Galleries, Inc., 1988-2 Trade Cas. (CCH) ¶¶ 68,340, 68,341 (N.D. Ill. 1988), consumers were told that graphic prints were original prints by Dali and Picasso when, the Commission has

² In addition to Section 13(b), Section 19(a)(2) of the FTC Act authorizes the Commission to sue in district court to obtain both equitable monetary relief and some types of damages for consumers injured by practices held to be unfair or deceptive in a prior FTC administrative proceeding.

alleged, the prints were not originals by the named artists, but merely reproductions.

In numerous pending cases brought under Section 13(b), the FTC has sought and obtained, as preliminary relief, the freeze or sequestration of millions of dollars possessed by the perpetrators of deceptive practices. If it prevails on the merits, the Commission then requests the court to disburse these frozen funds to consumers who have been parted from their monies by the defendants' deceptive practices.³ This Court's resolution of the present case may significantly affect the FTC's ability to accomplish restitution in pending and future cases and thereby to perform its statutory mission in an effective and efficient manner.

In at least two recent fraud cases brought by the Commission to secure a fund for injured consumers, the Internal Revenue Service ("IRS") is attempting to satisfy tax liens with impounded funds. If these efforts succeed, the amount of money left to distribute to injured consumers will be significantly reduced. For example, in FTC v. U.S. Oil & Gas Corp., No. 83-1702-Civ-

³ The FTC has previously distributed millions of dollars to consumers under final court orders for restitution. See, e.g., FTC v. Leland Indus., Inc., (1983-1987 Transfer Binder) Trade Reg. Rep. (CCH) ¶ 22,297 (C.D. Cal. Oct. 11, 1985) (\$ 2.5 million restitution for purchasers of oil lease filing services); FTC v. Alaska Land Leasing, Inc., 5 Trade Reg. Rep. (CCH) ¶ 22,459 (July 14, 1987); FTC v. Evans Products Co., 5 Trade Reg. Rep. (CCH) ¶ 22,480 (Oct. 22, 1987) (\$ 3.3 million redress for purchasers of prefabricated homes as to which availability of long-term financing was allegedly misrepresented); FTC v. Rare Coins of Georgia, 5 Trade Reg. Rep. (CCH) ¶ 22,309 (N.D. Ga. Dec. 5, 1988) (\$ 150,000 restitution for purchasers of overgraded rare coins).

Hoeverler (S.D. Fla. July 10, 1987), the IRS has placed a three million dollar jeopardy assessment on the estate of a principal of U.S. Oil & Gas Corporation. The estate contains approximately \$ 2.75 million that would go to the Commission for distribution to injured consumers unless the money is diverted to the payment of taxes. Additionally, in the same case, the IRS has seized \$ 432,000 held by an individual defendant in a safe deposit box, not withstanding an asset freeze order entered by the court at the Commission's request. Likewise, in FTC v. Worldwide Factors, Ltd., No. Civ.-S-88--293-RDF (LRL) (D. Nev. May 19, 1988), the IRS has indicated its intention to assert a claim against a fund of assets worth over \$ 1.5 million established by an asset freeze order entered at the FTC's request.⁴

Because many Section 13(b) cases involve fraud or conduct approaching fraud, the defendants in such cases have not infrequently engaged in wrongdoing beyond the specific practices that led to the FTC challenge. Such wrongdoing may include failure to pay state and federal taxes. Were this Court to construe the applicability of constructive trusts in the narrow fashion appellants suggest, the Commission would be severely hampered in returning monies to victims of fraud as the FTC Act authorizes.

⁴ In FTC v. Rainbow Enzymes, Inc., No. Civ-87-1522 (D. Ariz. 1988) following the district court's decision in the instant case, the IRS acquiesced in the Commission's proposed plan that \$ 1.5 million obtained from defrauded participants in a pyramid promotion scheme be returned to them.

STATEMENT OF THE CASE

On May 12, 1986, the SEC filed a complaint charging defendant Dennis B. Levine and his related companies with violations of Sections 10(b) and 14(e) of the Exchange Act, 15 U.S.C. §§ 78j(b) and 78n(e), and Rules 10b-5 and 14e-3, 17 C.F.R. §§ 240.10b-5 and 240.14e-3. The district court granted the SEC's motion for a temporary restraining order freezing approximately \$ 11.5 million in illegal insider-trading profits. On June 6, 1986, the district court approved a settlement that required the defendants to disgorge the funds into a receivership account.

On July 1, 1986, the SEC filed a similar action against defendant Wilkis and his related companies. On July 2, 1986, the district court approved a settlement similar to Levine's and ordered Wilkis to disgorge approximately \$ 3.3 million of his ill-gotten gains.

On November 16, 1987, the SEC filed proposed plans of distribution for the disgorged assets. Under the SEC proposal, defrauded investors would receive 55% of the fund and the federal and state tax authorities the remaining 45%. Various parties, including the IRS, objected to the proposed plans. The IRS, supported by the defendants, took the position that the federal tax claims were entitled to priority over all other

claims, because no liens other than federal tax liens had attached to the disgorged assets (Br. 11).⁵

The district court refused to approve the SEC-proposed plans and also rejected the contention of the IRS that the federal tax claims had priority over all other claims. SEC v. Levine, 689 F. Supp. 317 (S.D.N.Y. 1988). The court held that the disgorged assets were held in constructive trust for the benefit of defrauded investors (id. at 323). Because the defendants had acquired the disgorged assets through wrongful means, equitable title arose in the injured investors from the time the funds were wrongfully obtained. The assets could not, therefore, properly be considered "property of the taxpayer" within the meaning of Section 6321 of the Internal Revenue Code, 26 U.S.C. § 6321 (id. at 321-22). Consequently, the assets in the constructive trust were not susceptible to an IRS lien (id. at 323).

On October 27, 1988, the district court entered an order approving the SEC's amended distribution plan, which provided for the distribution to injured investors of all funds remaining after payment of administrative expenses. The United States, New York Department of Taxation, defendants Levine and Wilkis, and plaintiffs in a pending private action against Levine all sought permission to take an interlocutory appeal. On December 9, 1988, this Court granted the petitions for interlocutory review.

⁵ The abbreviation ("Br.") refers to Brief for The United States as Appellant.

SUMMARY OF ARGUMENT

In impressing illegal insider-trading profits with a constructive trust, the district court was exercising its inherent judicial power to fashion equitable remedies for violations of federal law. The district court correctly determined that a constructive trust could be imposed when the principles of equity so required, and that the forum state's constructive trust doctrine could be interpreted in a manner consistent with such principles. Particularly in the area of federal enforcement of statutory equitable rights, the district court's power to fashion appropriate remedies should be broadly construed.

The manner in which the court imposed the constructive trust in this case forestalled application of any federal tax claim priorities against the funds. Although the defendants' tax liabilities arising from the ill-gotten gains are not at issue here, the ability of the IRS to attach tax liens to those funds is. The IRS may only attach a lien on "property" or "rights to property" that belong to the taxpayer. See 26 U.S.C. § 6321. Here, the district court concluded that although the defendants held legal title to these funds, equitable title arose in the injured investors from the time the funds were wrongfully obtained. Thus, no tax liens could attach because the funds were never the defendants' "property".

The IRS argues that the taxpayers had equitable title to the illegally obtained funds until the constructive trust was

decreed by the court. The court, however, held that the defendants never had full title because the constructive trust, once imposed, related back to the time of the wrongdoing. This conclusion was fully in keeping with the court's equitable remedial powers. The fundamental purpose of a constructive trust is to make the wrongdoer a trustee responsible for preserving the assets in his possession for the benefit of the rightful owners. In the apparent view of the IRS, the "trustee" may freely dissipate the assets until a court order establishes the trust explicitly. This interpretation of the law would severely frustrate the FTC's ability to effect restitution to defrauded consumers.

ARGUMENT

I. THE DISTRICT COURT'S IMPOSITION OF A CONSTRUCTIVE TRUST IS WITHIN ITS STATUTORY AUTHORITY TO FORMULATE EQUITABLE REMEDIES FOR VIOLATIONS OF FEDERAL SECURITIES LAWS

The law is well-settled that, where federal regulatory agencies have been granted authority to enforce the law by means of a suit for injunction in federal court, they may seek the full range of equitable remedies (including disgorgement and restitution) that a federal district court, sitting in equity, is empowered to fashion.⁶ See, e.g., SEC v. Certain Unknown Purchasers, 817 F.2d 1018, 1020 (2d Cir. 1987); FTC v. U.S. Oil &

⁶ Under 15 U.S.C. § 53(b), the FTC can seek to invoke the full breadth of the court's equitable authority and request imposition of such relief as is necessary to remedy violations of any law enforced by the FTC. Similarly, the CFTC can invoke the court's inherent equitable powers under 7 U.S.C. § 13a-1 to enforce compliance with the Commodity Exchange Act, 7 U.S.C. § 2.

Gas Corp., 748 F.2d 1431, 1432-34 (11th Cir. 1984); CFTC v. Co Petro Marketing Group, Inc., 680 F.2d 573 (9th Cir. 1982); FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1113 (9th Cir. 1982); CFTC v. Hunt, 591 F.2d 1211 (6th Cir.), cert. denied, 442 U.S. 921 (1979); SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307 (2d Cir.), cert. denied, 404 U.S. 1005 (1971). The scope of the courts' inherent equitable powers is even greater when, as in these cases, the public interest is at stake. Porter v. Warner Holding Co., 328 U.S. 395, 397-99 (1946).

Equitable remedies are essential to the federal regulatory agencies' ability to combat civil fraud. Restitution and disgorgement are bottomed on the recognition that a wrongdoer should not be allowed to retain property that in equity and good conscience do not belong to him. Remedies to prevent unjust enrichment and redress injured consumers become meaningless, however, if the ill-gotten gains can be freely dissipated. To preserve assets for effective ultimate relief, the federal agencies have successfully invoked the district court's power to fashion appropriate preliminary and ancillary orders for asset freezes, accountings, receiverships, and immediate discovery.⁷

⁷ See, e.g., U.S. Oil & Gas, 748 F.2d at 1431 (receiver appointment aff'd); Co Petro Marketing, 680 F.2d at 584 (receiver appointment, accounting, and disgorgement aff'd); CFTC v. Muller, 570 F.2d 1296 (5th Cir. 1978) (asset freeze aff'd); FTC v. Rare Coin Galleries of America, Inc., 1986-2 Trade Cas. (CCH) ¶ 67,338 (D. Mass. 1986) (asset freeze granted); SEC v. R.J. Allen & Associates, Inc., 386 F. Supp. 866, 881 (S.D. Fla. 1974) (receiver appointed); SEC v. Capital Counsellors, Inc., 332 F. Supp. 291, 304 (S.D.N.Y. 1971) (receiver appointed).

The constructive trust is but another form of ancillary relief available to a court in exercising its equitable powers. D. Dobbs, Remedies § 4.3 (1973); Republic of Philippines v. Marcos, 806 F.2d 344, 355-56 (2d Cir. 1986) (preliminary injunction and constructive trust decreed). Through the constructive trust, equity converts the wrongdoer into a trustee holding the property for the benefit of the rightful owner. D. Dobbs, Remedies § 4.3; Beatty v. Guggenheim Exploration Co., 225 N.Y. 380, 386, 122 N.E. 378, 380 (1919) (Cardozo, J.), cited in Marcos, 806 F.2d at 355. Therefore, the theory of constructive trusts is the legal underpinning of the remedies for unjust enrichment and restitution. "A constructive trust is the formula through which the conscience of equity finds expression." Beatty, 225 N.Y. at 386, 122 N.E. at 380.

II. THE COURT'S AUTHORITY TO IMPOSE A CONSTRUCTIVE TRUST CANNOT BE THWARTED BY THE FORUM STATE'S CONSTRUCTIVE TRUST DOCTRINE

When the lower court ordered that the defendants' disgorged assets be held in constructive trust for the defrauded investors, the court was implementing a federal equitable remedy in an action brought under the federal securities laws. The court determined, in fact, that the forum state's law contemplated imposition of such a trust, effective at the time the unlawful taking of funds occurred. (689 F. Supp. at 323.) Even were this Court to read state law requirements less favorably, however, the district court should nonetheless be affirmed.

The Supreme Court and this Circuit have found that when state law cannot be reconciled with controlling federal statutory

authority, the state law must give way to the requirements of federal equity. In Holmberg v. Armbrecht, 327 U.S. 392, 397 (1946), the Supreme Court held that the doctrine of equitable tolling (whereby a statute of limitations is tolled until the plaintiff could reasonably discover the right of action concealed by defendant's fraud) is read into every federal statute, including those in which state statutes of limitation would otherwise govern. "It would be too incongruous to confine a federal right within the bare terms of a State statute of limitation unrelieved by the settled federal equitable doctrine as to fraud * * *" Id.⁸ This Court has further expanded on the Holmberg doctrine to find that "the selection of a limitations period is an exercise of the court's discretionary power to fashion appropriate measures to carry out the intent of the federal legislation." Robinson v. Pan American World Airways, Inc., 777 F.2d 84, 86 (2d Cir. 1985), cited in Assoc. Brick Mason Contractors, Inc. v. Harrington, 820 F.2d 31, 37 (2d Cir. 1987).

It is likewise incongruous to confine the federal constructive trust doctrine within technical state-defined prerequisites for constructive trusts, inconsistent with settled federal equitable doctrines.⁹ The power of a federal court to

⁸ The equitable tolling of statutes of limitation doctrine is applied to actions brought under the federal securities laws. See Morgan v. Koch, 419 F.2d 993, 996-97 (7th Cir. 1969); Sperry v. Baggren, 523 F.2d 708, 710-11 (7th Cir. 1975).

⁹ Ever since the First Judiciary Act, 1 Stat. 73, federal district courts have been given cognizance of suits "in equity," which "constitute that body of remedies, procedures, and practices which had been evolved in the English Court of

decree that property obtained through fraud or deception should be restored to its rightful owner cannot be undermined by the forum state's law.¹⁰ Such a result would severely undercut the ability of federal agencies, such as the SEC and FTC, to achieve effective, consistent, and nationwide enforcement of statutes designed to protect consumers throughout the country. As the Supreme Court stated in Holmberg:

We have the duty of federal courts, sitting as national courts throughout the country, to apply their own principles in enforcing an equitable right created by Congress. When Congress leaves to the federal courts the formulation of remedial details, it can hardly expect them to break with historic principles of equity in the enforcement of federally-created equitable rights. 327 U.S. at 395.

Because the instant case involves equitable remedies created pursuant to a federal statute, the doctrine of constructive trust should be flexible and not confined by a rigid reading of

Chancery, subject, of course, to modifications by Congress." Sprague v. Ticonic National Bank, 307 U.S. 161, 164-65 (1939). Thus, for example, although some states may require a breach of fiduciary duty as a prerequisite for the imposition of a constructive trust, this was not the case in early English Chancery practice and need not be the case in federal equity practice. 1 Pomeroy, Equity Jurisprudence (4th ed.) § 155.

¹⁰ As the Supreme Court stated in Burks v. Lasker, 441 U.S. 471, 479 (1979), "although a state statute cannot be considered inconsistent with federal law merely because the statute causes the plaintiff to lose litigation, federal courts must be ever vigilant to insure that application of state law poses no significant threat to any identifiable federal policy or interest." (citations omitted.) (The Court held that in suits alleging violations of the Investment Company Act (ICA) and the Investment Advisors Act (IAA), federal courts should apply state law in determining authority of directors to discontinue derivative suits to the extent such law is consistent with the policies of the ICA and IAA.)

the elements of constructive trusts under state law.¹¹ In Marcos, 806 F.2d at 356, this Circuit stated that the state law of constructive trust can be adopted by the federal court only "where adoption of state law does not conflict with federal policy." The clear implication is that state law must yield where it conflicts with overriding federal enforcement needs. Federal courts have followed this reasoning in deviating from state constructive trust doctrines when their application would conflict with the underlying equities of the federal bankruptcy statutes¹² and the Securities Investor Protection Act ("SIPA").¹³

"An appeal to the equity jurisdiction conferred on federal district courts is an appeal to the sound discretion which guides

¹¹ See Niagara Mohawk Power v. Bankers Trust Co. of Albany, 791 F.2d 242, 245 (2d Cir. 1986) (theory of unjust enrichment was dependent on federal common law because the equitable rights were generated by HUD's activities pursuant to federal statutes and, therefore, the district court erred in applying the heightened New York standard for piercing the corporate veil).

¹² In re North American Coin & Currency, Ltd., 767 F.2d 1573, 1575 (9th Cir. 1985) (cites omitted) (state constructive trust doctrine not applied, in part, because it would result in injured customers being treated unequally); In re Teltronics, Ltd., 649 F.2d 1236, 1240-41 (7th Cir. 1981) (constructive trust imposed and funds kept out of bankruptcy estate because defrauded customers treated equally); In re Johnson, 80 B.R. 791, 799-800 (Bankr. E.D. Va. 1987) (constructive trust imposed and funds kept out of bankruptcy estate defeating IRS lien because defrauded investors treated equally).

¹³ In re Bevill, Bresler & Schulman, Inc., Civ No. 85-2224 (DRD) (D.N.J. Jan. 10, 1989) (available on 1989 U.S. Dist. LEXIS 272) (state law doctrine of constructive trust must give way to the policy of SIPA because to do otherwise would frustrate its purpose; citing Chicago Board of Trade v. Johnson, 264 U.S. 1, 10 (1924), for the proposition that under the Supremacy Clause of the Constitution, inconsistent state laws must give way to a federal statute).

the determinations of courts of equity. * * * Flexibility rather than rigidity has distinguished it." Hecht Co. v. Bowles, 321 U.S. 321, 329 (1944). The lower court correctly found that the forum state's constructive trust doctrine must be interpreted in a fashion consistent with federal equity principles. If state law could not be reconciled with federal policy, it would have to yield to the federal statutory authority.¹⁴

III. A CONSTRUCTIVE TRUST DEFEATS IRS PRIORITY CLAIMS

Under the tax lien provisions of 26 U.S.C. Section 6321, the IRS can gain priority status by attaching "property" or "rights to property" belonging to defendants. The IRS reliance on Aquilino v. United States, 363 U.S. 509, 512 (1960), and its progeny for the proposition that the question of property ownership is one of state law is inapposite (Br. 24-25). In the context of the proper imposition of a constructive trust, there is little controversy as to the question of ownership once the

¹⁴ If state law must yield, the federal courts need not fashion a constructive trust doctrine out of whole cloth. Imposition of a constructive trust generally requires proof of three elements: (1) a wrongful act; (2) specific property acquired by the wrongdoer that is traceable to the wrongful behavior; and (3) an equitable reason why the party holding the property should not be allowed to keep it. Alsco-Harvard Fraud Litigation, 523 F. Supp. 790, 806-07 (D.D.C. 1981) (citations omitted). See American Serv. Co. v. Henderson, 120 F.2d 525 (4th Cir. 1941); In re Independent Clearing House Co., 41 B.R. 985 (Bankr. D. Utah 1984), aff'd in part, rev'd in part sub nom. In re Universal Clearing House Co., 62 B.R. 118 (D. Utah 1986). In the instant case, the IRS does not contest that the funds were obtained by a wrongful act; that the funds should be disgorged to prevent unjust enrichment; and that all but \$ 1.6 million of the funds can be traced to the wrongful act. If the SEC prevails in its argument that the \$ 1.6 million is also traceable, those funds can be held in constructive trust as well.

trust arises.¹⁵ When title to property is bifurcated, so that the taxpayer owns bare legal title and serves as a trustee for the benefit of a third party, the taxpayer's interest is insufficient for a tax lien to attach. Aquilino, 363 U.S. at 513-15. Courts that have addressed the issue of whether the imposition of a constructive trust defeats IRS priority tax claims have held that, by definition, once the constructive trust arises, the taxpayer as a constructive trustee lacks a sufficient interest in the trust property to permit a tax lien to attach. See United States v. Fontana, 528 F. Supp. 137, 143 (S.D.N.Y. 1981); Atlas, Inc. v. United States, 459 F. Supp. 1000, 1005 (D. N.D. 1978); First National Bank of Cartersville v. Hill, 412 F. Supp. 422, 426 (N.D. Ga. 1976); Dennis v. United States, 372 F. Supp. 563, 566 (E.D. Va. 1974).

The critical issue, therefore, is whether the lower court was correct in stating that the equitable title arose in the injured investors from the time the defendants illegally obtained the funds. The IRS argues that the taxpayers had equitable title to the illegally obtained funds until the constructive trust was decreed by the Court, thereby creating a window of time during which the tax liens could attach (Br. 15-16; 31-33).

¹⁵ See Sections I and II of the Argument. The lower court properly employed its equitable powers to impose a constructive trust to remedy violations of the federal securities laws.

In Fontana, 528 F. Supp. at 146, however, the court addressed this precise issue and held that "New York law holds a constructive trust to exist from the time of the occurrence of the circumstances giving rise to the duty to surrender the property in question to another." In finding that a constructive trust related back to the time of the wrongdoing, the court interpreted the New York law as incorporating notions of general equity. The court noted that allowing the IRS to seize property that, should the wronged party prevail, social conscience would reconvey, was a fundamentally unfair result that the New York Court of Appeals would reject. Id. at 145. The court specifically rejected the IRS argument against the relation back theory as an attempt to narrow the reach of equity. Id. at 146.

Relying on Fontana, the district court in the instant case found that New York law clearly permitted it to hold that the constructive trust arose at the time the defendants' wrongfully obtained the funds. In addition, because this state rule was consistent with the federal equitable policies at issue, the application of the state rule by the district court was proper. Burks, 441 U.S. at 480.

The IRS argues that a line can be drawn between the instant case and cases involving theft, embezzlement, and similar misconduct, conceding that a constructive trust can relate back in those situations but only because, under state property law, title never passed (Br. 32). To limit the relation back of constructive trusts in this fashion overlooks the fact that the

constructive trust arises to vindicate a statutorily prescribed federal interest in restitution for fraudulent acts. Cases of federal civil fraud in which the Commission is involved present compelling interests in the relation back theory that should be considered under federal law.¹⁶

Narrowing the relation back theory of constructive trust would severely impair the ability of the FTC to obtain monetary equitable relief for defrauded consumers. Even where a court had determined that funds were properly held in a constructive trust because they had been taken from consumers by means of fraud or other serious deception, such funds would nonetheless be available to satisfy the tax obligations of the wrongdoer prior to the time a constructive trust was declared by the court. This approach fails to account for the strong federal interest in compensating the victims of fraudulent and deceptive practices prohibited by the securities laws and the Federal Trade Commission Act. Although there is an inevitable tension between the federal interest in restitution and the Government's revenue priorities, we do not believe that those priorities necessarily contemplate the payment of taxes with funds fraudulently obtained and rightfully belonging to another.

¹⁶ "It would seem that there is no foundation whatever for the notion that a constructive trust does not arise until it is decreed by a court. It arises when the duty to make restitution arises, not when the duty is subsequently enforced." 5 Scott, *Trusts* (3d ed.) § 462.4. Accord *Fontana*, 528 F. Supp. at 145; *Reliance Insurance Co. v. Brown*, 40 B.R. 214 (W.D. Mo. 1984); Bogert, *Trusts & Trustees* (2d rev. ed.) § 472.

CONCLUSION

For the foregoing reasons, the decision and orders of the district court should be affirmed insofar as the court determined that funds disgorged into a receivership account were held in constructive trust for the benefit of injured investors from the time the misconduct occurred.

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