

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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COMMODITY FUTURES TRADING
COMMISSION,

Plaintiff,

-against-

STEPHEN WALSH, PAUL GREENWOOD,
WESTRIDGE CAPITAL MANAGEMENT, INC.,
WG TRADING INVESTORS, L.P., WGIA, LLC,

Defendants,

WESTRIDGE CAPITAL MANAGEMENT
ENHANCEMENT FUNDS INC, WG TRADING
COMPANY, LP, WGI LLC, K&L
INVESTMENTS, and JANET WALSH,

Relief Defendants.

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

WG TRADING INVESTORS, L.P., WG
TRADING COMPANY, LIMITED
PARTNERSHIP, WESTRIDGE CAPITAL
MANAGEMENT, INC., PAUL GREENWOOD
and STEPHEN WALSH,

Defendants,

-and-

ROBIN GREENWOOD AND JANET WALSH,

Relief Defendants.

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GEORGE B. DANIELS, DISTRICT JUDGE:

MEMORANDUM DECISION
AND ORDER

09 Civ. 01749 (GBD)

09 Civ. 01750 (GBD)

On February 25, 2009, Plaintiff Commodity Futures Trading Commission ("the CFTC")

and Plaintiff Security Exchange Commission (“the SEC”) filed separate complaints seeking preliminary and permanent injunctive, and other equitable, relief for alleged violations of the anti-fraud provisions of the federal securities laws, respectively, under the Commodity Exchange Act, and the Security Exchange Act and the Securities Act. CFTC v. Walsh et al., No. 09 Civ. 1749 (GBD) (S.D.N.Y.), and SEC v. WG Trading Investors L.P. et al., No. 09 Civ. 1750 (GBD) (S.D.N.Y.) (collectively, the “Actions”). Plaintiffs allege that the defendants misappropriated as much as \$554 million in investor funds during a decades-long securities fraud. Both complaints name Janet Walsh, presently known as Janet Schaberg (“Schaberg”), as a relief defendant.

The CFTC seeks a preliminary injunction to freeze all of the assets of Relief Defendant Schaberg.¹ The CFTC’s motion for preliminary injunction is granted, to the limited extent indicated herein.

BACKGROUND

Janet Schaberg is Defendant Stephen Walsh’s former spouse. Defendant Stephen Walsh and Janet Walsh were married in 1982. The couple signed a separation agreement (“Separation Agreement”) on November 1, 2006. On April 4, 2007, a New York state court entered a divorce decree, adopting the Separation Agreement. Janet Walsh remarried and assumed her current

¹ Following an order by the Court, dated May 29, 2009, compelling discovery, Relief Defendant Schaberg submitted an accounting to the CFTC. The following list includes all assets, held by Relief Defendant Schaberg, as disclosed in the CFTC’s Memorandum of Law and Schaberg’s deposition testimony: balances in twelve checking and/or brokerage accounts (approximately totaling \$7,611,137); jewelry (approximately totaling \$118,000); art (value not available); and real property located in Longboat Key, Florida (value not available). Prior to the couples’ formal separation and Settlement Agreement, Defendant Stephen Walsh gave Relief Defendant Schaberg \$3 million toward the purchase of a New York co-op. Schaberg sold the co-op in April of 2008. The \$3.5 million netted from the sale was used to pay off the mortgages on her current home. The CFTC seeks to freeze all twelve accounts, and put the remaining assets under receivership.

husband's last name, Schaberg. In 2009, federal criminal charges were initiated against Defendant Stephen Walsh. In the instant civil matters, both the CFTC and the SEC seek to recover millions of dollars of investor funds as a result of the alleged criminal fraud.

On February 25, 2009, the Court issued a statutory *ex parte* restraining order and asset freeze, in the CFTC Action, pursuant to 7 U.S.C. § 13a-1(a) that, among other things, froze all property belonging to Schaberg. The Court also entered an *ex parte* temporary restraining order and asset freeze in the SEC Action, pursuant to the Court's authority under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisors Act of 1940, freezing one of Schaberg's bank accounts.² Robb Evans & Associates LLC, is the duly appointed receiver ("Receiver") in both Actions. Pursuant to both restraining orders, the Receiver assumed control over several corporate defendants, including WG Trading Investors LP ("WGTI") and WG Trading Co. LP ("WGTC"). The temporary receivership was also extended to include the individual relief defendant in the CFTC Action, Janet Schaberg.

On March 2, 2009, the Court held oral argument on plaintiffs' orders to show cause

² The SEC freeze only applies to Schaberg's Bank of America checking account, account number ending in 2509, totaling approximately \$396,749. The SEC has since indicated its desire to seek a broader freeze against Relief Defendant Schaberg, on the basis of evidence acquired after the issuance of the temporary restraining order. Letter from the SEC to the Court (Apr. 13, 2009); (May Conference Transcript at 64-65) ("We will be seeking to expand the freeze as to . . . [Schaberg] as well. It didn't seem necessary to press that since the freeze was in place [in the CFTC Action] as to all of [Schaberg's] assets."). Because the Court instructed the CFTC to submit further support for the broad freeze it initially requested, and to submit a proposed order identifying specific assets, the instant Memorandum Decision and Order directly addresses the CFTC's formal motion for preliminary injunction. However, it should be noted that the SEC also made several submissions to refute Relief Defendant Schaberg's substantive arguments. See, eg., Letter from the SEC to the Court (Mar. 26, 2009); Letter from the SEC to the Court (Apr. 13, 2009). Also, the CFTC "adopts and incorporates by reference the [SEC's] position, articulated in its April 13, 2009 letter to the Court" Letter from the CFTC to the Court (Apr. 17, 2009).

regarding preliminary injunctions and asset freezes. At the close of argument, the Court found that the record supported the motion to convert the restraining order into a preliminary injunction. However, upon requests by defense counsel for several defendants and relief defendants, the Court granted the parties permission to submit supplemental materials to propose modifications to the orders. The parties were heard further on the motions on March 26, April 6, and May 19. The Court received various formal and informal submissions from both Relief Defendant Schaberg and the CFTC.³ On May 22, 2009, the Court issued a preliminary injunction against the defendants in both Actions. On the same date, the Court issued a preliminary injunction against the relief defendants in the SEC Action.

PRELIMINARY INJUNCTION

The CFTC seeks a preliminary injunction which, *inter alia*, would maintain the asset freeze covering all of Schaberg's assets, and subject them to the Receiver's possession and control. The CFTC argues that such action is necessary to ensure the availability of assets to satisfy a potential disgorgement order. In order to support the request for a preliminary injunction, the CFTC has the burden of demonstrating to the Court that it is likely to prevail on the merits. SEC v. Cavanagh, 155 F.3d 129, 132 (2d Cir. 1998).⁴ It is a "well-

³ Although, to date, Schaberg has not filed a motion to dismiss or a motion for summary judgment, she initially contested the asset freeze *in toto*, claiming lack of subject matter jurisdiction. However, Schaberg voluntarily agreed to comply with an order in the CFTC Action that mirrored the SEC's preliminary injunction and freeze order. See Letter from Janet Schaberg to the Court at 2 (May 26, 2009) (claiming, however, that Schaberg "reserves her rights to challenge such provisions at an appropriate time").

⁴ "To show likelihood of success on the merits, the party seeking the injunction need not show that success is an absolute certainty. The movant need only make a showing that the probability of [] prevailing is better than fifty percent." Nat'l Elevator Cab & Door Corp. v. H&B, Inc., 282 Fed. Appx. 885, 888 (2d Cir. 2008) (quoting Abdul Wali v. Coughlin, 754 F.2d

established rule that in actions for a statutory injunction, such as this, the agency need not prove irreparable injury or the inadequacy of other remedies as required in private injunctive suits” CFTC v. British Am. Comm. Options Corp., 560 F.2d 135, 141 (2d Cir. 1977) (citing SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 807- 09 (2d Cir. 1975); SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1101 (2d Cir. 1972)); Cavanagh, 155 F.3d at 132 (citing SEC v. Unifund Sal, 910 F.2d 1028, 1037 (2d Cir. 1990)). Yet, even if the movant meets its burden regarding the merits, equitable principles demand that, at this stage of the litigation prior to issuing injunctive relief, “there must exist a substantial probability that jurisdiction, judgment, and enforcement will be obtained with respect to the person sought to be affected.” United States v. First Nat’l City Bank, 379 U.S. 378, 390, 85 S.Ct. 528, 13 L.Ed.2d 365 (1964) (Harlan, J., dissenting).

The Court has wide discretion to “order disgorgement of ill-gotten gains, and calculation of those gains” SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996) (citing SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995)). The Court “may order equitable relief against a person who is not accused of wrongdoing in a securities enforcement action where that person: (1) has received ill-gotten funds; and (2) does not have a legitimate claim to those funds.” Cavanagh, 155 F.3d at 136. “The [CFTC] has to show that the funds to be frozen may be subject to ultimate execution.” First Nat’l City Bank, 379 U.S. at 394 (“If the property cannot be subjected to [disgorgement], there is obviously no equity in freezing it.”).

Here, Relief Defendant Schaberg concedes that “[a] court order restraining and enjoining her from dissipating those specified assets . . . [later found] to be ill-gotten and to which she has no legitimate claim is sufficient to preserve the *status quo*.” (Relief Defendant Schaberg Opp.

1015, 1025 (2d Cir. 1985) (stating that “[t]here may remain considerable room for doubt.”)) (internal quotation and citation omitted); Mohammed v. Reno, 309 F.3d 95, 102 (2d Cir. 2002) (defining the phrase as a “likelihood . . . [of] more than 50 percent”).

Mem. at 10) (emphasis in original). Additionally, she maintains that “if the Court preliminarily finds [that she possesses funds subject to disgorgement], the CFTC asset freeze should be modified to pertain only to the allegedly ill-gotten funds.” (Id. at 9.)

Ill-Gotten Funds

In an action for disgorgement, “[t]he party seeking disgorgement must distinguish between the legally and illegally derived profits.” CFTC v. Am. Bd. of Trade, Inc., 803 F.2d 1242, 1252 (2d Cir. 1986) (citing British Am., 788 F. 2d at 93). The CFTC contends that Relief Defendant Schaberg received close to \$19 million in ill-gotten funds, from WGTI, during the period of the alleged fraud. Schaberg testified that most of the funds currently located in her accounts constitute funds that originated from one account into which Defendant Stephen Walsh regularly transferred funds. The funds were transferred from Defendant WGTI’s bank account to Relief Defendant Schaberg’s account throughout the period of the alleged fraud.

Further, the Receiver’s Report indicates that the company faced a cash shortfall of at least \$311.5 million between January 1, 1999 and February 25, 2009. Over \$50 million was transferred from WGTI to Stephen Walsh, affiliates, and family members. Based on the Receiver’s review of corporate records, Schaberg, individually, received over \$19.7 million.

Relief Defendant Schaberg argues that the CFTC has not met its burden to demonstrate that the funds were wrongfully obtained by simply stating that they came from a corporate account. Schaberg maintains that the funds could be attributed to her former husband’s successful business ventures. However, Schaberg provides no evidence that the funds remaining in her accounts can be traced to legitimate proceeds of unrelated business activities. Schaberg’s conclusory suppositions are insufficient to rebut the inference that much of the funds identified by the CFTC likely represent the proceeds of fraud. Moreover, there is no evidence in the record

contradicting the CFTC's *prima facie* showing that the identified transfers involved ill-gotten gains, particularly given the greater amount of the alleged fraud and financial losses. The CFTC has met its burden to demonstrate that it is likely to prevail on the merits of its claim that funds transferred to Schaberg from Defendant WGTI's checking account constitute proceeds of fraud.

Legitimate Claim

Plaintiff has also demonstrated the second requirement of the Cavanagh test. The CFTC has met its burden to show that, more likely than not, Relief Defendant Schaberg does not have a legitimate claim to what is likely the proceeds of fraud. Schaberg contends that "any property [she] currently possesses is, or was derived from, property received or *retained* pursuant to the property settlement and divorce." Letter from Schaberg to the Court at 6 (June 12, 2009) (emphasis added). Prior to the November 1, 2006 date that Relief Defendant Schaberg signed the couple's Separation Agreement, Schaberg received over \$16.3 million directly from a WGTI bank account. Relief Defendant Schaberg argues that even if the identified funds represent misappropriated investor funds, a divorce decree, which incorporates a purely voluntary separation agreement, automatically has the power to cleanse the taint of fraudulent proceeds previously transferred to a spouse prior to, and completely independent of, the dissolution of a marriage.⁵ Schaberg does not contend that she gave any consideration in exchange for a share of

⁵ The incorporation of the terms of the parties' Separation Agreement into a divorce decree does not bestow upon Schaberg a legitimate and superior interest in the funds at issue. The divorce court may have been in a position to determine property rights as between a husband and wife, however it could not validate a former spouse's retention of monies fraudulently obtained during the marriage. Equity would not stand to "allow an incidental contract [] adopted by two contracting parties simply for their own convenience to thwart the operation of federal [] law." First Nat'l City Bank, 379 U.S. at 544 (Harlan, J. dissenting). Such a rule would clearly encourage all manner of marital collusion. The rule Schaberg urges the Court to adopt would serve to deprive non-parties to the divorce proceeding of their property rights, usurp the CFTC and the SEC's statutory mandate to protect the public interest, and undermine this Court's authority to fashion an appropriate remedy in the event disgorgement is deemed necessary relief.

the allegedly fraudulently obtained funds at issue. “Allowing [a relief defendant] to now claim valid ownership of those proceeds would allow almost any defendant to circumvent the [CFTC and the] SEC’s power to recapture fraud proceeds by the simple procedure of giving [assets] to friends and relatives” Cavanagh, 155 F.3d at 136. The CFTC has established that there is a likelihood of more than fifty percent that it will be able to demonstrate that Relief Defendant Schaberg does not have a legitimate claim to the purported ill-gotten gains channeled to her account by her then-husband Defendant Stephen Walsh.

The CFTC seeks to freeze all assets held in the name of, or on behalf of, Relief Defendant Schaberg. Relief Defendant Schaberg testified that she deposited funds previously transferred, during the years of her marriage, to her from Defendant Walsh into several accounts held in her name. The CFTC has identified twelve accounts, previously frozen under the statutory restraining order, totaling approximately \$7,611,137. The evidence available at this juncture indicates that an asset freeze of Schaberg’s assets, totaling approximately \$7,587,544 is justified.⁶

Conclusion⁷

A preliminary injunction and asset freeze, precluding dissipation of approximately \$7,587,544 in specified accounts held by Relief Defendant Schaberg, is warranted under the

⁶ Accounts untouched by the freeze are either: empty (Merrill Lynch account, with a balance of \$0); possibly financed by an alternate source (MetLife shares purportedly inherited from Schaberg’s mother, valued at \$331); or hold negligible amounts of money (Citibank accounts, account numbers ending in 7051 (money market account), 7051 (checking account), and 9511, with respective balances of \$2,981, \$3,182, and \$2,571).


⁷ The freeze order, as preliminary relief, merely maintains the status quo. At the appropriate time, the CFTC may still seek to pursue other identifiable assets held by, or on behalf of, Relief Defendant Schaberg that they can establish were the proceeds of fraud.

circumstances.⁸ The asset freeze described in the CFTC's proposed preliminary injunction order for relief defendants is hereby amended to include, and is limited to, the following accounts and their balances:⁹

- (1) Brokerage account, number ending in 392, account balance approximately \$465,932;
- (2) Checking account, number ending in 2509, account balance approximately \$396,749;
- (3) Brokerage account, number ending in 604, account balance approximately \$227,199;
- (4) Brokerage account, number ending AI2, account balance approximately \$3,056,242;
- (5) Orion account, number N/A, account balance approximately \$2,506,131; and
- (6) Annuity/Retirement Account, account balance approximately \$935,291.¹⁰

Dated: New York, New York
August 4, 2009

SO ORDERED:



GEORGE B. DANIELS
United States District Judge

⁸ The Court amends the CFTC's proposed preliminary injunction order to remove the provision mandating receivership of Relief Defendant Schaberg's assets. However, during the pendency of this action, Relief Defendant Schaberg may not transfer, dispose of, or encumber any real property, jewelry, or art, she owns or has an ownership interest in, without prior notice to the plaintiffs and the receiver, and prior approval of this Court.

⁹ The accounts listed above are designated as follows in the CFTC's Memorandum of Law: 2(D), 2(E), 2(F), 2(H), and 2(J), 2(K).

¹⁰ The CFTC has established that, more likely than not, it will be able to demonstrate that nearly all assets held by Relief Defendant Schaberg were derived from the allegedly fraudulent activities of Defendant Stephen Walsh. Schaberg testified that she did not assume paid employment after her marriage to Defendant Stephen Walsh in 1982. Schaberg's deposition testimony that she used funds from her checking account to fund the annuity, and that Defendant Stephen Walsh did not provide the funding for the annuity, is inadequate to counter the inference to be drawn from the CFTC's evidence. The annuity will remain frozen in the absence of a sufficient showing by Relief Defendant Schaberg that it is derived from a separate source of funds, and does not represent the proceeds of fraud.