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**IN THE UNITED STATES DISTRICT COURT
DISTRICT OF UTAH, CENTRAL DIVISION**

<p>SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. 4NEXCHANGE, a Utah limited liability company, PAUL R. GRANT, and RONALD K. BASSETT, Defendants.</p>	<p>MEMORANDUM IN SUPPORT OF ROBERT AND SUSAN COVINO'S MOTION FOR LIMITED INTERVENTION AND FOR RETURN OF FUNDS</p> <p>Civil Action No. 2:02CV-431K</p> <p>Judge Dale A. Kimball</p>
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Robert and Susan Covino submit this memorandum in support of their motion for limited intervention and for return of funds in the amount of \$1,987,423.60 held by Robert G. Wing, Esq., the Court appointed receiver in the referenced matter (the "Receiver").

SUMMARY

Robert and Susan Covino are victims of the 4NExchange scheme. They invested at least \$2,357,423.60. They never received any money from 4NExchange.

Of the Covino's investment, \$1,987,423.60 was forwarded to 4NExchange on April 26, 2002 in the form of two New Jersey checks. The checks were deposited in Utah and presented to payor banks in New Jersey through the Federal Reserve System on May 1, 2002. Pursuant to applicable UCC statutes and banking regulations, the checks were not deemed finally paid by the payor banks until midnight on May 2, 2002--after this Court's Temporary Restraining Order, Order of Asset Freeze, Prohibiting Destruction of Documents and Order to Show Cause (the "Freeze Order").

The Covinos maintain that as a matter of law and equity the \$1,987,423.60 (the "Provisional Funds") are not part of the Receiver's estate in this case and that they are entitled to intervene and be granted an order directing the immediate return to them of those funds.

BACKGROUND FACTS

The pertinent background facts to this Motion are undisputed and are based on the accompanying Affidavit of Robert Covino and the documents on file in this action.

The Covinos invested a total of at least \$2,357,423.60 in 4NExchange. They never received any monies back. Through August of 2001, the Covinos made a series of deposits totaling at least \$370,000.00 into the 4NExchange program. The Covinos

are not seeking a return of those funds as part of this motion. However, the Covinos are seeking a return of the \$1,987,423.60 Provisional Funds. The Covinos raised those funds by refinancing and borrowing on the equity in their home on April 26, 2002.

As a result of the refinancing, the Covinos were issued two checks. The first check was issued by Commerce Bank (Check No. 011203) in the amount of \$650,000.00, payable to Robert and Susan Covino. The second check was drawn on the attorney trust account of Craig Hughes, Esq. (the closing attorney) at Summit Bank (now Fleet Bank, N.A.) (Check No. 2552) in the amount of \$1,337,423.60, payable to Robert M. and Susan Covino.

The Covinos endorsed both checks to 4NExchange, LLC. The checks were sent via Federal Express by the Covinos to defendant Paul Grant. On or about April 27, 2002, Mr. Grant endorsed the checks on behalf of 4NExchange, LLC and delivered them to America First Credit Union for deposit into 4NExchange's account.

On May 1, 2002, the checks were presented to Commerce Bank and Fleet Bank, respectively, through the Federal Reserve System. Under applicable law, both Commerce Bank and Fleet Bank had until midnight of the banking day following receipt of the checks to return them unpaid. See UCC §§ 4-104(a)(10); 4-105; 4-215; 4-301. Accordingly, the Covinos could have stopped the transfer of the Provisional Funds through midnight of May 2, 2002.

On May 2, 2002, the instant action was commenced. At approximately 11:40 a.m. Mountain time on May 2, 2002, this Court entered a temporary restraining order which inter alia, froze the status quo of 4NExchange's account at America First Credit Union.

At 11:40 a.m. Mountain time on May 2, 2002, the Covinos could still have caused “stop payment” orders to be issued as to the checks and prevented the transfer of their funds. However, the Covinos (who are New Jersey residents) were not advised of the temporary restraining order or the commencement of this case in time to do so. Had the Covinos known of this action early enough on May 2, 2002, they would have caused payment on the checks to be stopped.

On July 12, 2002, this Court entered an Order granting the Receiver’s motion to return nine checks received from potential investors after May 2, 2002. The Receiver sought permission to return the checks because, “[t]he checks were never deposited into a 4NExchange account, and hence were not part of the Receivership estate.”

ARGUMENT

I. THE COVINOS ARE ENTITLED TO INTERVENE ON THE LIMITED ISSUE OF THE DISPOSITION OF PROVISIONAL FUNDS.

Intervention is governed by Fed. R. Civ. P. Rule 24. The Covinos fit squarely within the provision relating to intervention as of right as they claim an interest in property which is the subject of this action and their ability to protect that interest may be impaired by the disposition of this action. Their interests are not adequately represented by existing parties. Permissive intervention is also appropriate because the question of law relating to the return to the Covinos of the Provisional Funds is common to, and must be resolved with, the issues in connection with the main action.

II. AS A MATTER OF LAW, THE PROVISIONAL FUNDS WERE NOT PROPERTY OF 4NEXCHANGE AT THE TIME OF THE FREEZE ORDER.

The Provisional Funds represented by the Covinos' checks were not "finally paid" within the meaning of the applicable law at the time of the Freeze Order and were therefore not subject to judicial process.

Until a check has been finally paid (UCC § 4-215) by the payor bank (UCC § 4-105(3)), within the meaning of the UCC provisions and Federal Reserve regulations governing bank deposits and collections, any credit given by the collecting depository bank (UCC § 4-105(2); § 4-105(5)) to its customer is provisional (UCC § 4-201).¹ That is because before an item has been finally paid, it is subject to return. 12 CFR §210.12.

Provisional credits are not property subject to levy, garnishment or other judicial process. DNI Nevada, Inc. v. Medi-Peth Medical Lab, Inc., 766 A.2d 1197 (N.J. App. Div. 2001).² In DNI Nevada, the court recognized that a depository bank is required to give only provisional credit for checks that are deposited but not finally settled. "Federal and state regulations governing the availability of funds in the context of banking transactions do not convert a provisional credit, which is a fictitious fund, [into] an asset that can be levied upon. In this context, the levy is not the same as payment of the funds to a third party. [The bank] can charge back against those funds even if they are levied upon." Id. at 1200.

Another illustrative case is Zucker v. United States Computer Corp., 408 N.E.2d 41 (Ill. App. 1980). In Zucker, a creditor levied upon a judgment debtor's bank account.

¹ Utah has adopted the Uniform Commercial Code (Utah Code Ann. Title 70A), as has New Jersey (N.J.S.A. Title 12A). References in this memorandum are to the UCC without regard to state numbering.

² Accord, UCC § 4-215(e), which provides that deposited checks for which provisional credit has been given are not available for withdrawal as of right by the customer until after the settlement for the item has become final. Cf. United States v. National Bank of Commerce, 472 U.S. 713 at 724-725 (1985) (taxpayer's unrestricted right to withdraw constitutes "property" subject to IRS levy).

Several days earlier, a check had been deposited into the account. However, the deposited check had not been finally paid at the time of the levy. The court held that the garnishment did not reach the check because prior to final settlement of the check, any provisional credit given by the receiving bank could be withdrawn. The court stated:

[P]rior to final settlement it is unknown if any indebtedness will ever become due. There is always a possibility that the payor bank will dishonor the check, in which case the collecting bank can exercise its right to revoke provisional credit given the customer and charge-back against the customer's account. The bank's indebtedness to its customers becomes due only upon final settlement, and prior to that time it is only speculation whether such indebtedness will ever become due.

Id. at 45 (internal citations omitted).

Similarly, in State Bank of Southern Utah v. Stallings, 427 P.2d 744 (Utah 1967), the Utah Supreme Court recognized that so long as the drawer of a check has the power to stop payment, the funds remain his property. Also, in Anderson v. Stephens, 875 F.2d 76 (4th Cir. 1989), the Fourth Circuit recognized that property acquired after issuance of a freeze order does not become part of a receivership estate but instead belongs to the originating persons or entities.

The legal principle that provisional credits may not be garnished is both logically sound and practically essential. A rule otherwise would expose the depository bank, the payor bank, any intermediate banks, and the drawer of the check to loss inconsistent with the complex and carefully structured check collection rules. For example, what if the payor bank lawfully and timely exercised its right to revoke settlement due to insufficient funds, a stop payment order, or otherwise. On whom would the loss fall? On the payor bank? On the intermediate collecting banks? Or the depository bank,

which is then faced with the dilemma of both honoring the levy and also complying with the UCC and Federal Reserve regulations?

In contrast, as the courts have observed, the determination that provisional credit is not subject to judicial process, leads to consistent and ascertainable results. The statutes and regulations governing bank deposits and collections provide a detailed set of rules for determining the rights and liabilities of the parties involved. From these rules, the question of when an item has been finally paid can be answered mechanically, leading to an equitable line for the scope of garnishments, levies and freeze orders --- if the deposit is provisional, it is not subject to the judicial process; if it has been finally paid, it is subject to such process.

III. THE FREEZE ORDER DID NOT CREATE NEW PROPERTY RIGHTS.

As of the time of the Freeze Order, the Provisional Funds were not property of 4NExchange, because the checks had not been finally paid. The Provisional Funds remained subject to return by the payor banks, stop payment by the Covinos, or judicial process against the funds in the possession of the payor banks. 4NExchange had no absolute right to that money.

The Freeze Order prevented any changes in the 4NExchange bank account; it did not create new or alter existing substantive property rights. See CFTC v. American Metal Exchange Corp., 991 F.2d 71, 79 (3d Cir. 1993) (freeze order is designed to preserve the status quo). It would be contrary to the language and intent of the Freeze Order for it be applied in such a way as to convert the Provisional Funds into property of 4NExchange.³

³ In addition, the Covinos' property rights are governed by applicable state law. Cf. Butner v. U.S., 440 U.S. 48, 55 (1979). Interpreting the Freeze Order to alter or impair those rights would raise constitutional concerns. See, e.g., Fuentes v. Shevin, 407 U.S. 67 (1972).

There is no legal or equitable justification for treating the Covinos any differently from the investors whose undeposited checks were returned by the Receiver on application to the Court. In both the case of the undeposited checks and the Covinos' checks that were not finally paid, the funds had not become property of 4NExchange at the time the Freeze Order was issued. Just as the undeposited checks were returned to investors in accordance with the principle discussed in Anderson v. Stephens, supra, so too, the Covinos are entitled to return of the Provisional Funds. Furthermore, just as the undeposited checks remained separate from the other monies in the bank account, the Provisional Funds remained an identifiable separate res subject to return.

IV. EQUITY FAVORS RETURN OF THE FUNDS TO THE COVINOS.

As this Court and the Receiver have already recognized, a line must be drawn with respect to the 4NExchange account. On one side of the line are investors who are entitled to a return of their funds. On the other side are investors who will share the remaining balance of the 4NExchange account of a pro-rata basis. The issue before this Court is on which side of the line the Covinos fall.

The line should be drawn in relation to the entry of the Freeze Order. This is so for two reasons. First, the entry of the Freeze Order occurred at an objectively verifiable time --- 11:40 a.m. Mountain time on May 2, 2002. A fixed date and time provides a clear and convenient yardstick for analyzing the parties' rights. Second, by definition, the purpose of a "freeze" order is to preserve rights as of a particular moment. By "freezing" the account, this Court prevented 4NExchange from withdrawing funds in its possession thereby preserving a pool of assets for the victims. Further, by "freezing" the 4NExchange account, this Court prevented other potential victims from having their funds sucked into an illegal Ponzi Scheme. Since the intent of the Freeze

Order was to maintain the status quo as of a particular moment in time, the rights of the parties must be evaluated as of that particular moment in time.

The Receiver and this Court have already recognized that investors whose checks were received after the Freeze Order are entitled to a return of those checks. Likewise, investors whose checks were received, deposited, and given final credit into the 4NExchange account before the Freeze Order are entitled to pro-rata distribution. The Covinos fall somewhere in between. The Covinos checks were received and deposited before the Freeze Order. However, their checks were subject only to provisional credit at the time of the Freeze Order. After the Freeze Order, the Covinos still had the right to stop payment on the checks and recover their funds.

As between the two, the Covinos' position is more closely analogous to that of the investors whose checks were received after the Freeze Order. At the time of the Freeze Order, the Covinos and the investors whose checks had not been deposited all had the power to stop payment and recover their funds. At the time of the Freeze Order, 4NExchange had not received "final" credit over any of those funds. In neither situation did 4NExchange have an absolute right to withdraw the funds.

Thus, the legally significant event is not the writing of a check, or even the depositing of a check into an account. Instead, the legally significant event is when that check becomes subject to "final" credit. It is only at that moment in time that the check writer loses the right to stop payment. It is only at that moment in time that the depositor has an unfettered an absolute right to withdraw the funds. At the moment in time that the Freeze Order was entered, final credit had not been given to the Covinos checks or to the checks that were returned to other investors.

The remaining investors, i.e., those whose checks were already subject to final credit into the 4NExchange account, cannot make the same claims. Those investors already lost the ability to stop payment and 4NExchange already had the absolute right to withdraw their funds.

Accordingly, it is equitable and proper to treat the Covinos in a similar manner to the investors whose checks are returned. By doing so, this Court will draw the line in an absolute and objectively verifiable fashion. Drawing the line in this fashion will ensure consistency and avoid drawing distinctions on arbitrary facts devoid of true legal relevance.

Further, drawing the line in such a fashion harmonizes with the well-recognized law cited above: account funds subject only to provisional credit are not subject to levy. "It is an ancient maxim that 'Equity follows the law' and the law conserves and enforces rights, never destroys them." Kenyon v. Automatic Instrument Co., 160 F.2d 878, 884 (6th Cir. 1947), citing, Pomeroy's Equity Jurisprudence, 4th Ed., Sec. 1577. Accord, Smith v. Batchelor, 832 P.2d 467, 471 (Utah 1992) ("Equity follows the law. It cannot abridge an explicit, statutory requirement.")

Returning the funds to the Covinos does not impair the rights of other investors. The 4NExchange account will not lose funds that were finally and absolutely subject to withdrawal. The monies placed into the account by the other investors will not be compromised. Instead, the funds that 4NExchange could have withdrawn at 11:40 a.m. Mountain time on May 2, 2002 will remain frozen. The status quo will be preserved and the rights of the investors in that body of funds will remain unaltered.

Any other approach would simply be inequitable gerrymandering to increase the funds available to other victims of 4NExchange. The Covinos are certainly cognizant

of the plight of those victims. In fact, the Covinos invested at least an additional \$370,000 prior to the Freeze Order which funds are not a subject of this motion. However, at the end of the day, the Covinos should not be made insurers of the investor deposits.

V. THE COURT HAS THE AUTHORITY TO RELEASE THE COVINOS' FUNDS.

"If the court has the authority to freeze personal assets temporarily, it logically has the 'corollary authority to release frozen personal assets, or lower the amount frozen.'" SEC v. Dowdell, 175 F.Supp.2d 850, 854 (W.D.Va. 2001), citing SEC v. Duclaud Gonzalez de Castilla, 170 F.Supp.2d 427 (S.D.N.Y. 2001).

CONCLUSION

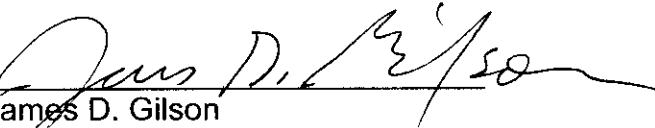
Based on the foregoing, the Covinos respectfully request that the Court permit them to intervene and order the return to them of the \$1,987,423.60 Provisional Funds.

Dated: November 26, 2002.

BRESSLER, AMERY & ROSS, P.C.

- and -

CALLISTER NEBEKER & McCULLOUGH

By: 
James D. Gilson
Attorneys for Robert and Susan Covino

CERTIFICATE OF SERVICE

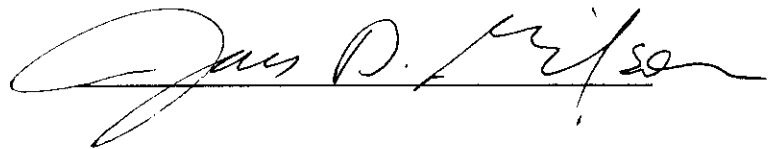
I hereby certify that I caused a true copy of the foregoing MEMORANDUM IN SUPPORT OF ROBERT AND SUSAN COVINO'S MOTION FOR LIMITED INTERVENTION AND FOR RETURN OF FUNDS to be mailed, first class postage prepaid, on the 26 day of November, 2002, to the following:

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A handwritten signature in black ink, appearing to read "Jay P. Wilson", written over a horizontal line.