No. 00-147

In the Supreme Court of the United States

SECURITIES AND EXCHANGE COMMISSION,
PETITIONER

v.

CHARLES ZANDFORD

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a stockbroker's fraud is "in connection with the * * * sale" of securities under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, when the stockbroker sells his customer's securities for his own benefit and uses the proceeds for himself, without disclosure to his customer and without authorization to do so.

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The Solicitor General, on behalf of the Securities and Exchange Commission (SEC or Commission), respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-14a) is reported at 238 F.3d 559. The memorandum, order, and judgment of the district court granting the Commission's motion for summary judgment (App., *infra*, 15a-24a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on January 26, 2001. A petition for rehearing was denied on March 26, 2001 (App., *infra*, 51a). On June 16, 2001, Chief Justice Rehnquist extended the time within which to file a petition for a writ of certiorari to and

including July 24, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE AND RULE INVOLVED

The texts of 15 U.S.C. 78j(b) and 17 C.F.R. 240.10b-5 are reproduced in Appendix G, *infra*, at 52a-53a.

STATEMENT

1. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security * * *, any manipulative or deceptive device or contrivance in contravention of such rules and reglations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78j(b) (*reprinted in* App., *infra*, 52a). SEC Rule 10b-5 implements Section 10(b) by declaring it unlawful, "in connection with the purchase or sale of any security," "(a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. 240.10b-5 (*reprinted in* App., *infra*, 52a-53a).

2. In 1987, respondent Charles Zandford, a stockbroker, convinced William Wood to open a joint brokerage account for Wood and his daughter, Diane Wood Okstulski. Wood was an elderly man in poor health, and his daughter was both mentally retarded and mentally ill. Wood and Okstulski (the Woods) entrusted respondent with $419,255 to "conservatively invest" in his discretion. Respondent, however, me-

thodically siphoned money from the Woods' investment account to accounts that respondent owned or controlled. Respondent did so by repeatedly selling securities in the Woods' account in order to acquire the proceeds. Respondent never disclosed his activities to the Woods. By September 1990, all of the Woods' funds were gone. App., *infra*, 2a, 10a, 28a-29a, 34a, 41a-42a.

In April 1995, a federal grand jury in the District of Maryland indicted respondent on thirteen counts of wire fraud in violation of 18 U.S.C. 1343. App., *infra*, 2a; see *id.* at 40a-50a (superseding indictment). The indictment charged respondent with "devis[ing] a scheme and artifice to defraud and to obtain money and property from [the Woods] by means of false and fraudulent pretenses, representations, and promises." *Id.* at 41a. Specifically, it alleged that respondent had "caused checks to be issued against the security positions of [the Woods] and made payable to [himself], thereby causing their securities to be liquidated." *Ibid.* The indictment also alleged that respondent "sold securities in [the Woods'] joint investment account, * * * and then made personal use of the money." *Id.* at 42a. A jury found respondent guilty of all of the wire fraud charges, and the district court sentenced respondent to a prison term of 52 months. *Id.* at 2a. The court of appeals, finding "ample direct and circumstantial evidence showing that [respondent] had engaged in a scheme to defraud the Woods" (*id.* at 36a), affirmed respondent's convictions and sentence. *Id.* at 33a-39a.

3. In September 1995, the SEC brought this civil law enforcement action against respondent in the United States District Court for the District of Maryland. App., *infra*, 25a-32a. The Commission's complaint alleged that, between May and June 1988, without the Woods' knowledge or consent, respondent issued

checks to himself drawn on the Woods' joint mutual fund account, and that the funds to pay the checks were obtained through the sale of mutual fund shares in that account. *Id.* at 28a. The complaint further alleged that, on several occasions between July 1988 and June 1990, respondent sold mutual fund shares or other securities owned by the Woods without their knowledge or consent and misappropriated the proceeds of the sales. *Id.* at 29a. The complaint charged that respondent thereby violated Section 10(b) and Rule 10b-5. *Id.* at 30a-31a.[1]

In April 1998, the Commission filed a motion for summary judgment in which it relied on the collateral estoppel effect of respondent's criminal convictions to establish that he intentionally defrauded the Woods. Respondent filed a motion to conduct discovery, but he did not move for summary judgment. In March 1999, the district court denied respondent's motion for discovery, granted the Commission's motion for summary judgment, enjoined respondent from future violations of the antifraud provisions, and ordered him to disgorge $343,000 in illegally obtained funds. App., *infra*, 3a, 15a-24a.

4. Respondent appealed. The United States Court of Appeals for the Fourth Circuit not only reversed the district court's grant of summary judgment in favor of the SEC, but also remanded the case with directions to dismiss the complaint. App., *infra*, 1a-14a. The court of

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[1] The complaint also alleged that respondent violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a). App., *infra*, 25a, 30a-31a. We do not seek this Court's review, however, of the question whether the complaint stated a claim under Section 17(a) because we have not identified a square conflict between the decision of the court of appeals in this case and decisions of this Court or other courts of appeals on that question.

appeals observed at the outset that, even if "the criminal trial established the fact that [respondent] sold securities as part of a scheme to misappropriate proceeds," respondent's criminal convictions did not collaterally estop him from contesting the district court's "legal conclusion" that "such a scheme satisfies the 'in connection with' requirement" of Section 10(b). *Id.* at 5a. Reviewing that legal conclusion, the court of appeals held that respondent's "alleged fraudulent activities were not sufficiently connected to a securities transaction to merit liability under [Section] * * * 10(b)." *Id.* at 14a.

The court noted that, "to state a claim under § 10(b) of the Exchange Act and Rule 10b-5," the Commission must show that respondent's fraud was "in connection with" the purchase or sale of any security. App., *infra*, 6a (quoting 15 U.S.C. 78j(b)). The court concluded that the SEC had failed to make that showing because, in the court's view, respondent's "securities sales were incidental to his scheme to defraud. [Respondent's] fraud lay in absconding with the proceeds of the sales. The record contains no suggestion that the sales themselves were conducted in anything other than a routine and customary fashion." *Id.* at 9a.

In explaining why it determined that respondent's conduct was not "in connection with" any securities transaction, the court stated that respondent's fraudulent "statements or omissions were not about a particular security" (App., *infra*, 13a), "did not make any reference to the attributes of a specific security" (*id.* at 10a), and did not "induce the Woods or anyone else to buy or sell a particular stock" (*id.* at 13a). The court also stated that "the goal of § 10(b) would not be served by expanding its scope to include 'claims amounting to breach of contract or common law fraud which have

long been the staples of state law.'" *Id.* at 8a (quoting *Hunt* v. *Robinson*, 852 F.2d 786, 787-788 (4th Cir. 1988)). The court concluded that, "while [respondent] breached a fiduciary duty to the Woods, the Supreme Court has emphasized that the federal securities laws are not an open-ended breach of fiduciary duty ban." *Id.* at 14a (citing *United States* v. *O'Hagan*, 521 U.S. 642, 655 (1997), and *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462 (1977)). In light of its conclusions, the court of appeals remanded the case to the district court "with directions to dismiss it." *Ibid.*

The court of appeals subsequently denied the Commission's petition for rehearing and rehearing en banc. App., *infra*, 51a.

REASONS FOR GRANTING THE PETITION

A stockbroker violates Section 10(b) when, without authorization or disclosure, he sells customer securities for his own benefit and uses the proceeds for himself. The contrary decision of the court of appeals conflicts with the decision of this Court in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), and with the decision of the United States Court of Appeals for the Ninth Circuit in *United States* v. *Kendrick*, 692 F.2d 1262 (1982), cert. denied, 461 U.S. 914 (1983). The decision below also conflicts with the interpretation of the securities laws reflected in over a half century of SEC decisions, and, if allowed to stand, it will significantly impair the Commission's ability to enforce those laws for the protection of investors. Review by this Court is therefore warranted.

1. The court of appeals erred in holding that respondent's alleged fraudulent conversion of the Woods' securities and the proceeds of the sales of those securities was not "in connection with" those sales in violation

of Section 10(b). Respondent's fraud was integrally connected to the securities sales because the sales were both the direct result of respondent's deception of the Woods and the means by which he accomplished the goal of his fraud—the conversion of their assets.[2]

Section 10(b) prohibits the use, "in connection with the purchase or sale of any security," of "any manipulative or deceptive device or contrivance" in violation of rules promulgated by the Commission. 15 U.S.C. 78j(b). SEC Rule 10b-5 in turn prohibits "any person" from "employ[ing] any device, scheme, or artifice to defraud," or "engag[ing] in any act [or] practice" that "operates or would operate as a fraud or deceit upon any person," "in connection with the purchase or sale of any security." 17 C.F.R. 240.10b-5(a) and (c). Thus, Section 10(b) encompasses "(1) using any deceptive device (2) in connection with the * * * sale of securities." *United States* v. *O'Hagan*, 521 U.S. 642, 651 (1997).

The Commission's complaint in this case alleged that respondent, without the Woods' knowledge or consent, issued checks to himself drawn on a mutual fund account held by the Woods, and that the funds to pay the checks were obtained through the sale of mutual fund shares in that account. App., *infra*, 28a. The Commission further alleged that, on several occasions, respondent sold mutual fund shares or other securities owned by the Woods without their knowledge or

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[2] Because the court of appeals, rather than merely reversing the district court's grant of summary judgment, dismissed the Commission's complaint for failure to state a claim, this Court must assume that the allegations in the complaint are true and could affirm the dismissal only if the Commission could prove no set of facts that would entitle it to relief. See *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764, 811 (1993).

consent and misappropriated the proceeds of the sales. *Id.* at 29a. See also *id.* at 41a-42a (superseding indictment) (making similar allegations). That course of conduct establishes both elements of a Section 10(b) violation—(1) fraud (2) in connection with the sale of securities.

Fraud: That respondent defrauded the Woods is established by respondent's criminal convictions for wire fraud under 18 U.S.C. 1343. See *O'Hagan*, 521 U.S. at 654 (equating fraud under mail fraud statute with fraud under Section 10(b)). The Woods entrusted their assets to respondent for him to invest for their benefit. As their agent, respondent owed the Woods a duty of loyalty and had authority to use their assets only for their benefit and not to enrich himself. See Restatement (Second) of Agency § 387 (1958) ("Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency."); App., *infra*, 14a (acknowledging that respondent "breached a fiduciary duty to the Woods"). When, without disclosure to the Woods, respondent acted beyond the scope of his authority and in breach of his duty of loyalty, respondent committed fraud. See *O'Hagan*, 521 U.S. at 653-654 ("A fiduciary who '[pretends] loyalty to the principal while secretly converting the principal's [property] for personal gain' * * * 'dupes' or defrauds the principal.") (second brackets added); *Carpenter* v. *United States*, 484 U.S. 19, 27 (1987) ("The concept of 'fraud' includes the act of embezzlement, which is 'the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another.'") (quoting *Grin* v. *Shine*, 187 U.S. 181, 189 (1902)). Indeed, the court of appeals did not question that respondent engaged in fraud.

In connection with the sale of securities: Respondent's fraud was "in connection with" the sale of the Woods' securities because the sales were the means by which respondent accomplished the goal of his fraudulent scheme. The complaint alleged that checks that respondent issued to himself drawn on the Woods' mutual fund account triggered the sale of mutual fund shares in the account. App., *infra*, 28a. The complaint further alleged that, on repeated occasions, respondent sold mutual fund shares or other securities in the Woods' account, caused checks to be issued in the amount of the proceeds of the sales, and deposited those checks in accounts under his control. *Id.* at 29a. In those instances, as the complaint alleged, and the court of appeals assumed, the sales were the means by which respondent "generated" the cash that he stole. *Ibid.*; *id.* at 2a.

Respondent's fraud was also "in connection with" the sales of the Woods' securities because the sales were the direct result of his deception. If a broker who planned to sell his customer's securities for his own benefit disclosed his plans to the customer, the customer would take action to prevent the sales. The court of appeals thus erred in concluding that respondent's "security sales were incidental to his scheme to defraud." App., *infra*, 9a. On the contrary, the sales lay at the heart of respondent's fraudulent scheme.

This Court's decision in *O'Hagan* illustrates the court of appeals' error. O'Hagan committed fraud by stealing information entrusted to him by his employer, to which he owed a fiduciary duty, and using the information for personal profit by trading in securities. The Court held that his fraud was "in connection with" his securities transactions "because the fiduciary's fraud is consummated, not when the fiduciary gains the confidential

information, but when, without disclosure to his principal, he uses the information to purchase or sell securities." *O'Hagan*, 521 U.S. at 656.

Respondent's fraud was even more closely connected to the purchase or sale of securities than O'Hagan's. First, respondent did not misappropriate information; he misappropriated securities and the proceeds of securities sales. Second, respondent deceived the owners of the securities, who were parties to the securities sales that he transacted. O'Hagan, on the other hand, deceived the owner of the confidential information, who was not a party to O'Hagan's securities transactions. See *O'Hagan*, 521 U.S. at 656 (holding that, under the misappropriation theory of insider trading, the securities transaction and the breach of duty to disclose coincide "*even though* the person or entity defrauded is not the other party to the [securities] trade" (emphasis added)). Because O'Hagan's fraud was "in connection with the purchase or sale" of securities, it follows *a fortiori* that respondent's fraud also had the required connection.[3]

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[3] The court of appeals attempted to distinguish *O'Hagan* as limited to insider trading. See App., *infra*, 11a. Nothing in *O'Hagan*, however, suggests that the Court's analysis of the "in connection with" requirement is limited to insider trading cases. The court of appeals also incorrectly suggested (*id.* at 12a) that this case is comparable to the hypothetical discussed in *O'Hagan* of someone who "defrauded a bank into giving him a loan or embezzled cash from another, and then used the proceeds of the misdeed to purchase securities." *O'Hagan*, 521 U.S. at 656. The securities purchase in the hypothetical, however, was not necessary to or part of the fraud. In this case, in contrast, the securities transactions were integral to respondent's fraudulent scheme. Respondent could not have accomplished his fraud without the securities sales, which consummated the fraudulent conversion of the securities and generated the cash that he misappropriated.

O'Hagan also illustrates that the court of appeals erred in reasoning that respondent's fraud did not have the requisite connection to a securities transaction because his misrepresentations "were not about a particular security" (App., *infra*, 13a) and "did not make any reference to the attributes of a specific security" (*id.* at 10a). See *SEC* v. *Jakubowski*, 150 F.3d 675, 679 (7th Cir. 1998) (Easterbrook, J.) (explaining that *O'Hagan* demonstrates that the connection requirement does not limit Section 10(b) to misrepresentations about the value of securities), cert. denied, 525 U.S. 1103 (1999). The "in connection with" requirement does not limit the subject matter of prohibited misrepresentations. Rather, it demands a "connection"—a nexus—between the misrepresentation, whatever its subject matter, and the purchase or sale of any security. See *SEC* v. *Clark*, 915 F.2d 439, 449 (9th Cir. 1990); *Abrams* v. *Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582, 593 (7th Cir. 1984); *Brown* v. *Ivie*, 661 F.2d 62, 65 (5th Cir. 1981), cert. denied, 455 U.S. 990 (1982). The necessary connection exists "when [as in this case] the proscribed conduct and the sale are part of the same fraudulent scheme." *Alley* v. *Miramon*, 614 F.2d 1372, 1378 n.11 (5th Cir. 1980) (Wisdom, J.).[4]

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[4] Courts of appeals have frequently found the "in connection with" requirement satisfied in cases in which the misrepresentation did not concern the attributes of a particular security. See *Press* v. *Chemical Inv. Servs. Corp.*, 166 F.3d 529 (2d Cir. 1999) (broker-dealer's failure to disclose to a customer purchasing a Treasury note that funds from the maturing note would not be available on the maturity date); *Jakubowski*, 150 F.3d at 679 (purchaser's misrepresentation of his identity); *Angelastro* v. *Prudential-Bache Sec., Inc.*, 764 F.2d 939 (3d Cir.) (misrepresentations about interest rates on a margin account), cert. denied, 474 U.S. 935 (1985); *Marbury Mgmt., Inc.* v. *Kohn*, 629 F.2d 705 (2d Cir.)

Finally, *O'Hagan* makes clear that the court of appeals also erred in reasoning that respondent's conduct did not have the requisite connection to a securities transaction because it was actionable under state law. See App., *infra*, 8a ("the goal of § 10(b) would not be served by expanding its scope to include claims amounting to breach of contract or common law fraud which have long been the staples of state law" (internal quotation marks and citation omitted)); *id.* at 14a (covering respondent's conduct under federal securities law would "subsume significant areas of state law"). In *O'Hagan*, this Court reiterated what it has held several times: the fact that there may also be liability under state law does not preclude liability under Section 10(b). See 521 U.S. at 655. Because Section 10(b) "trains on conduct involving manipulation or deception," a Section 10(b) action, like the one here, that is premised on deception presents no improper federalization of state law. *Ibid.* Compare *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1090-1095 & n.6 (1991) (securities fraud because there was deception), with *Santa Fe Indus.* v. *Green*, 430 U.S. 462, 474 (1977) (no securities fraud because there was full disclosure). In this case, "[s]ince there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under [Section] 10(b), whatever might be available as a remedy under state law." *Bankers Life*, 404 U.S. at 12; see also 15 U.S.C. 78bb(a)

(securities salesman's fraudulent representation that he was a licensed registered representative when he was a trainee), cert. denied, 449 U.S. 1011 (1980); *Arrington* v. *Merrill Lynch, Pierce, Fenner & Smith*, 651 F.2d 615 (9th Cir. 1981) (misrepresentation of the risks of buying securities on margin in a declining market); *Fey* v. *Walston & Co.*, 493 F.2d 1036 (7th Cir. 1974) (churning of customer accounts).

(1994 & Supp. V 1999) (Subject to limited exceptions not relevant here, "the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity."); *Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 121 S. Ct. 1776, 1782 (2001); *Basic Inc.* v. *Levinson*, 485 U.S. 224, 244 n.22 (1988).

2. a. This Court's review is warranted because the erroneous decision of the court of appeals conflicts with this Court's decision in *Bankers Life*, *supra*. In *Bankers Life*, the defendants led a company's board of directors to believe that the company would receive the proceeds from a proposed sale of Treasury bonds, when in fact the defendants intended to misappropriate the proceeds for their own use. 404 U.S. at 9. This Court reversed a decision of the Court of Appeals for the Second Circuit in which that court, much like the Fourth Circuit here, held that Section 10(b) did not apply to misappropriation of the proceeds of a sale of securities because "[t]here is a structural difference between the sale of the corporation's bonds at a concededly fair price and the subsequent fraudulent misappropriation of the proceeds received." 430 F.2d 355, 360 (1970). This Court rejected that reasoning, holding that the "in connection with" requirement was satisfied when the board of directors was deceived about the reason for the sale of its securities, regardless of whether "the proceeds of the sale * * * were misappropriated." 404 U.S. at 10.

Although the Second Circuit in *Bankers Life* had acknowledged that, if the board had known that the defendants "intended to misappropriate the proceeds for their own use[,] it undoubtedly would not have authorized their sale," that court nonetheless held, like the Fourth Circuit in this case, that the fraud was not in

connection with the sale of a security. 430 F.2d at 360. As the Fourth Circuit did here, the court of appeals in *Bankers Life* reasoned that the "deception did not infect the subsequent sales transaction." 430 F.2d at 360. Compare App., *infra*, 9a ("The record contains no suggestion that the sales themselves were conducted in anything other than a routine and customary fashion."). This Court rejected that reasoning, and held that, although "the full market price was paid for th[e] bonds," because the board had been "duped into believing that it * * * would receive the proceeds," "[w]e cannot agree * * * that the 'purity of the security transaction and the purity of the trading process were unsullied.'" 404 U.S. at 9-10.

The court of appeals in this case attempted to distinguish *Bankers Life* on the ground that, in that case, the defendants made a misrepresentation about a particular security that induced the sale of the security. App., *infra*, 13a. That purported distinction does not withstand scrutiny. Although *Bankers Life* may have involved a misrepresentation rather than, as in this case, silence in the face of a duty to disclose, the distinction is of no legal significance. Omissions are treated the same as false statements as long as there is a duty to disclose the information. See *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153 (1972) (finding liability under Section 10(b) even though "these defendants may have made no positive representation or recommendation. * * * The sellers had the right to know that the defendants were in a position to gain financially from their sales."); see also *Chiarella* v. *United States*, 445 U.S. 222, 228 (1980) ("the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence be-

tween them'") (quoting Restatement (Second) of Torts § 551(2)(a) (1976)).

Because respondent had a fiduciary duty to his customers, he also had a duty to disclose to them that he was going to sell the securities they had entrusted to him and use the proceeds for his own benefit. Further, as explained above, see p. 9, *supra*, respondent's failure to disclose his plans permitted him to carry out the sales, just as the misrepresentation in *Bankers Life* caused the directors to authorize the sale. Finally, the distinction drawn by the court of appeals cannot be justified on the ground that respondent's deception did not concern "a particular security" (App., *infra*, 13a) because the same is true of the deception in *Bankers Life*, and the scope of Section 10(b) is not restricted to misrepresentations about particular securities and their attributes, see p. 11, *supra*.

b. This Court's review is also warranted because the decision of the court of appeals conflicts with the decision of the Ninth Circuit in *United States* v. *Kendrick*, 692 F.2d 1262 (1982). In *Kendrick*, the court of appeals held that a stockbroker who converted to his own use money that he obtained from customer margin accounts that were secured by the pledge of securities engaged in fraud in connection with the sale of securities. *Id.* at 1264-1266. The stockbroker wrote checks payable to himself on the margin accounts, and those transactions were recorded as loans to the customers secured by the pledged securities. *Id.* at 1264. The court first explained that a pledge of securities to secure a loan is a sale of securities within the meaning of the securities laws. *Id.* at 1265. See *Rubin* v. *United States*, 449 U.S. 424, 431 (1981); *Mallis* v. *FDIC*, 568 F.2d 824, 829-830 (2d Cir. 1977), cert. dismissed, 435 U.S. 381 (1978). The court held that a sale of securities occurred each time a

check was issued, because the brokerage firm each time acquired an additional interest in the pledged securities. 692 F.2d at 1265. The court next explained that the broker engaged in fraud because he "failed to disclose to his customers * * * that he was acting beyond his authority in using customer funds for his own use." *Id.* at 1265-1266. Finally, the court concluded that the fraud was "in connection with" the sales because the broker was engaged in the fraud at the time he caused the brokerage firm to issue the checks on the margin accounts, which was the time at which the sales occurred. *Ibid.* Here, as in *Kendrick*, respondent was engaged in his fraudulent failure to disclose his intention to convert the Woods' assets when he issued the checks to himself that required the sale of the Woods' mutual funds, and when he sold other of the Woods' securities in order to steal the proceeds.[5]

The decision of the court of appeals in this case not only conflicts with the Ninth Circuit's decision in *Kendrick*, but its reasoning cannot be reconciled with decisions of other courts of appeals involving fraudulent conversions of securities. In *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1027-1029 (6th Cir. 1979), the court of appeals held that a brokerage firm violated Section 10(b) by fraudulently converting a customer's securities when it wrongfully refused to return bonds that the customer had earlier pledged to the firm as

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[5] In *Pross* v. *Katz*, 784 F.2d 455 (1986), and *Flickinger* v. *Harold C. Brown & Co.*, 947 F.2d 595 (1991), the Second Circuit held that there was no violation of Section 10(b) when stock was fraudulently converted several months or years after its purchase. Even if those decisions were correct, they would not support the holding of the court of appeals in this case, because here respondent's fraudulent deception and the sale of the Woods' securities were simultaneous. See App., *infra*, 28a-29a.

collateral. Citing *Bankers Life*, the court concluded that "[t]he 'in connection with' requirement has easily been met." *Id.* at 1028. Moreover, in *Allico National Corp.* v. *Amalgamated Meat Cutters*, 397 F.2d 727 (7th Cir. 1968), which was cited with approval by this Court in *Bankers Life*, 404 U.S. at 10 n.7, the court of appeals held that the defendant's fraudulent conversion of the plaintiff's securities from an escrow account set up to implement a sale "quite clearly occurred 'in connection with' its transaction with plaintiffs." 397 F.2d at 729.

3. Finally, this Court should review and reverse the decision of the Fourth Circuit in this case because the decision conflicts with the SEC's longstanding and consistent interpretation of the securities laws, and because, if it is allowed to stand, it will significantly impair the Commission's ability to enforce those laws for the protection of investors. For over 50 years, the Commission has interpreted Section 10(b) and Rule 10b-5 to prohibit the fraudulent misappropriation of the proceeds of securities sales, and it has brought numerous injunctive and administrative actions to enforce that prohibition.[6]

There would be a serious gap in investor protection if the court of appeals' decision were allowed to stand and were followed by other courts. Brokers play a critical role in enabling the participation of investors in the

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[6] See, *e.g.*, *Kenneth Leo Bauer*, 26 S.E.C. 770, 773-776 (1947); *D.S. Waddy & Co.*, 30 S.E.C. 367 (1949); *Southeastern Sec. Corp.*, 29 S.E.C. 609, 611-614 (1949); *Calvert Sec. Corp.*, 35 S.E.C. 141, 143 (1953); *Stuart F. Beck*, Exchange Act Release No. 19,916, 28 SEC Docket 303 (June 27, 1983); *SEC* v. *Faitos*, Litigation Release No. 12,786, 48 SEC Docket 528 (Feb. 27, 1991); *SEC* v. *Frank L. Harris*, No. CA 4:01CV117 (E.D. Tex. Apr. 6, 2001) (described in Litigation Release No. 16,954, 74 SEC Docket 2058 (Apr. 6, 2001)). Cf. *SEC* v. *Lawson*, 24 F. Supp. 360 (D. Md. 1938) (Section 17(a)).

securities markets, and frauds that impair customer assets erode investor confidence and undermine the operation of the markets. No other provision of the federal securities laws provides an equally effective alternative to Section 10(b) for bringing actions against stockbrokers who fraudulently misappropriate customer property.[7]

The decision of the court of appeals will be even more harmful if it is interpreted to mean that a deception must concern the "attributes of a particular security"

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[7] Although Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), on which the Commission also relied below (see note 1, *supra*), also prohibits fraud in the sale of securities, the conduct at issue here would not be prohibited by Section 17(a) if it is not covered by Section 10(b). See *United States* v. *Naftalin*, 441 U.S. 768, 773 n.4 (1979). Section 15(c) of the Exchange Act, 15 U.S.C. 78o(c), prohibits brokers or dealers from engaging in fraudulent conduct "to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security," but that provision covers only securities traded in the over-the-counter market, not securities traded on exchanges. Section 21(d)(1) of the Exchange Act, 15 U.S.C. 78u(d)(1), authorizes the Commission, in some circumstances, to bring an injunctive action based on a violation of the rules of a securities industry self-regulatory organization, such as the National Association of Securities Dealers. Section 21(f), 15 U.S.C. 78u(f), however, makes clear that the Commission "shall not bring any action pursuant to subsection (d) * * * for violation of * * * the rules of a self-regulatory organization unless" the Commission finds that the self regulatory organization "is unable or unwilling to take appropriate action" or it is otherwise necessary or appropriate in the public interest for the Commission to bring such an action. The Commission also can bring administrative proceedings against brokerage firms and their personnel under Section 15(b)(4) and (6) and Section 21C of the Exchange Act, 15 U.S.C. 78o(b)(4) and (6), 78u-3, but only based on a violation of a provision of the securities laws, such as Section 10(b), or a criminal conviction.

(App., *infra*, 10a) to be "in connection with the purchase or sale of any security." Securities fraud—particularly by stockbrokers—often does not involve a misrepresentation about the attributes of a particular security. Deceptive conduct by brokers frequently includes churning customer accounts, misrepresentations about the qualifications of broker-dealers, and misrepresentations about the risks of margin accounts. Under the broader reading of the decision of the court of appeals, the Commission could not bring actions under Section 10(b) and Rule 10b-5 against persons who engage in such conduct—actions that are authorized and brought today under the law in other circuits. See note 4, *supra*.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 2001

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 99-1733

SECURITIES & EXCHANGE COMMISSION,
PLAINTIFF-APPELLEE

v.

CHARLES ZANDFORD, DEFENDANT-APPELLANT

[Argued: Oct. 30, 2000]

[Decided: Jan. 26, 2001]

Before WILKINSON, Chief Judge, and MICHAEL and TRAXLER, Circuit Judges.

OPINION

WILKINSON, Chief Judge:

Defendant Charles Zandford was convicted of thirteen counts of wire fraud for stealing from two of his investment clients. The Securities and Exchange Commission subsequently filed this civil action against Zandford under § 17(a) of the Securities Act of 1933, § 10(b) of the Securities Exchange Act of 1934, and the SEC's Rule 10b-5. The district court granted the SEC's motion for summary judgment. Zandford now

appeals. We hold that the federal securities laws do not reach every claim for the theft or conversion of a security from a brokerage account. Because Zandford's fraudulent actions were not sufficiently connected with a securities transaction, we reverse the judgment of the district court and remand with directions to dismiss the case.

I.

Between 1987 and 1991, Charles Zandford worked as a securities broker. In 1987, Zandford persuaded William Wood to open a joint investment account for himself and his daughter, Diane Wood Okstulski. Wood was an elderly man who was in poor health. His daughter was mentally retarded and suffered from a multiple personality disorder. Zandford promised to "conservatively invest" the Woods' money. In total, the Woods entrusted Zandford with $419,255. By September 1990, all of it was lost.

In April 1995, a federal grand jury indicted Zandford on thirteen counts of wire fraud in violation of 18 U.S.C. § 1343. The indictment alleged that Zandford engaged in a scheme to defraud the Woods. The first count maintained that Zandford sold the Woods' shares of a mutual fund in order to use the proceeds for his own benefit. The remaining counts related to twelve separate checks from the Woods' account that Zandford made payable to himself. Zandford generated money in the Woods' account by selling their securities. A jury convicted Zandford on all counts. Zandford was sentenced to 52 months imprisonment and was ordered to pay $10,800 in restitution. This court subsequently affirmed Zandford's conviction. *See United States v. Zandford*, 110 F.3d 62 (4th Cir. 1997) (Table).

In September 1995, the Securities and Exchange Commission filed this civil action against Zandford under Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. The SEC's complaint alleged that Zandford violated these laws by selling the securities in the Woods' account, by misappropriating $343,000 in proceeds, and by using the money for his own personal needs. The SEC sought to enjoin Zandford from further violating the federal securities laws and to recover Zandford's ill-gotten gains.

In April 1998, the SEC moved for partial summary judgment on its misappropriation claim. Zandford subsequently moved for permission to conduct limited discovery on the issue of whether his fraud was "in connection with" a securities transaction. On March 2, 1999, the district court denied Zandford's motion and granted the SEC's motion for summary judgment. The court determined that Zandford's criminal conviction for wire fraud established all facts necessary to satisfy the elements of the SEC's securities fraud claim. Therefore, the court held that the doctrine of collateral estoppel prevented Zandford from arguing that he was not civilly liable under the federal securities laws. The court enjoined Zandford from committing future violations of the securities laws. It also ordered Zandford to disgorge $343,000. Zandford now appeals.[1]

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[1] The SEC contends that Zandford's notice of appeal was untimely. Because the district court did not abuse its discretion when it construed Zandford's motion for reconsideration of the summary judgment order and subsequent letter as a motion for an extension of time, the notice of appeal was timely filed. *See*

II.

The district court determined that Zandford's criminal conviction for wire fraud established all facts necessary to satisfy the elements of the SEC's securities fraud claim. That court erred in holding that the doctrine of collateral estoppel prevented Zandford from contesting his civil liability under the federal securities laws.

A criminal conviction can prevent a party from relitigating issues in a subsequent civil proceeding. *See Emich Motors Corp. v. General Motors Corp.*, 340 U.S. 558, 568, 71 S. Ct. 408, 95 L.Ed. 534 (1951). For collateral estoppel to apply, the SEC must establish that: (1) the issue sought to be precluded is identical to one previously litigated; (2) the issue must have been actually determined in the prior proceeding; (3) determination of the issue must have been a necessary part of the proceeding; (4) the prior judgement must be final and valid; and (5) the party against whom estoppel is asserted must have had a full and fair opportunity to litigate the issue in the previous forum. *See Sedlack v. Braswell Services Group, Inc.*, 134 F.3d 219, 224 (4th Cir. 1998).

At the very least, the SEC's invocation of collateral estoppel fails to satisfy the "identity of issues" requirement. To establish that Zandford violated sections 17(a) and 10(b), the SEC must prove, *inter alia*, that Zandford committed fraud "in the offer or sale" of sec-

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Fed. R. App. P. 4(a)(5); *see also Thompson v. E.I. DuPont de Nemours & Co., Inc.*, 76 F.3d 530, 534 (4th Cir. 1996) (reviewing district court's determination of the existence of excusable neglect for abuse of discretion).

urities, or "in connection with the purchase or sale" of securities. *See* 15 U.S.C. § 77q(a); 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. By contrast, under the wire fraud statute, the government only need prove that (1) Zandford engaged in a scheme to defraud, and (2) that he used inter-state wire communications in executing his scheme. *See* 18 U.S.C. § 1343; *United States v. ReBrook*, 58 F.3d 961, 966 (4th Cir. 1995). Thus, to find Zandford guilty of wire fraud it was wholly unnecessary to determine whether his fraud was sufficiently connected to a securities transaction. Since Zandford was never charged with a criminal violation of § 10(b), he did not have the opportunity to argue at trial or on appeal that, as a legal matter, his fraud was not sufficiently connected to a securities transaction. The SEC concedes as much when it argues both that the criminal trial established the fact that Zandford sold securities as part of a scheme to misappropriate proceeds, and that the district court properly made a legal conclusion in this case that such a scheme satisfies the "in connection with" requirement. It is this legal conclusion which we will now review.

III.

A.

The Securities Act of 1933 was designed "to provide full and fair disclosure of the character of securities sold . . . and to prevent frauds in the sale thereof, and for other purposes." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 728, 95 S. Ct. 1917, 44 L.Ed.2d 539 (1975). Likewise, "the fundamental purpose of the Securities Exchange Act of 1934 [was] to implement a 'philosophy of full disclosure,' by providing participants in stock transactions with the information they need to

make their investment decisions." *Hunt v. Robinson*, 852 F.2d 786, 787 (4th Cir. 1988) (quoting *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-78, 97 S. Ct. 1292, 51 L.Ed.2d 480 (1977)) (citation omitted).

The federal securities laws do not cover all types of fraud. Rather, both the Securities Act and the Exchange Act require that the defendant's fraud be connected sufficiently to a securities transaction. To state a claim under § 17(a) of the Securities Act, the SEC must show that Zandford's fraud, misstatement, or omission occurred "in the offer or sale of any securities." 15 U.S.C. § 77q(a).[2] Likewise, to state a claim under § 10(b) of the Exchange Act and Rule 10b-5, the SEC must show, *inter alia*, that Zandford misrepresented or failed to state material facts "in connection with" the purchase or sale of a security. *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.[3]

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[2] Section 17(a) of the Securities Act of 1933 provides:

> It shall be unlawful for any person in the offer or sale of any securities . . .
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a).

[3] Section 10(b) of the Exchange Act provides, in pertinent part, that:

The precise contours of the in connection with requirement are not self-evident. It seems unavoidable "that the standard be fleshed out by a cautious case-by-case approach." *See Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 942-43 (2d Cir. 1984) (*quoting Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 595 (5th Cir. 1974)). While the in connection with requirement must be flexible, it is not so elastic as to cover incidents which bear no relationship to market integrity or investor understanding. In particular, it is clear that ordinary state law fraud or conversion claims

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> It shall be unlawful for any person, directly or indirectly . . . (b) To use or employ, in connection with the purchase or sale of any security [,] . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b).

Rule 10b-5, promulgated by the SEC pursuant to section 10(b), provides, in relevant part, that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce . . .
>
> (a) [t]o employ any device, scheme, or artifice to defraud, [or] . . .
>
> (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5. Liability under Rule 10b-5 does not extend beyond conduct encompassed by § 10(b)'s prohibition. *See United States v. O'Hagan*, 521 U.S. 642, 651, 117 S. Ct. 2199, 138 L.Ed.2d 724 (1997).

do not invariably violate the federal securities laws. "Congress, in enacting the securities laws, did not intend to provide a federal remedy for all common law fraud." *Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc.*, 840 F.2d 236, 241 (4th Cir. 1988) (*citing Marine Bank v. Weaver*, 455 U.S. 551, 556, 102 S. Ct. 1220, 71 L.Ed.2d 409 (1982)). Indeed, the goal of § 10(b) would not be served by expanding its scope to include "claims amounting to breach of contract or common law fraud which have long been the staples of state law." *Hunt*, 852 F.2d at 787-88. With these principles in mind, we turn to the merits of Zandford's appeal.

B.

The precise issue before us is whether Zandford's alleged fraud is sufficiently connected to a securities transaction, as required by § 17(a) of the Securities Act, § 10(b) of the Exchange Act, and Rule 10b-5. The SEC advocates a very broad reading of the in connection with requirement. It alleges that Zandford defrauded the Woods by failing to inform them that he intended to sell their securities in order to obtain the proceeds for himself. The SEC argues that this omission was fraudulent since Zandford, as the Woods' investment adviser, bore a duty to disclose material information to the Woods. The SEC contends that Zandford's omissions were in connection with Zandford's sale of the securities in the Woods' account.

We do not believe that the federal securities laws extend to Zandford's fraudulent activities. The SEC has alleged what amount to ordinary state law fraud and conversion claims. In order to satisfy the in connection with requirement, "the fraud must have been integral to the plaintiff's purchase or sale of the

security." *Flickinger v. Harold C. Brown & Co., Inc.*, 947 F.2d 595, 598 (2d Cir. 1991); *see also Taylor v. First Union Corp. of South Carolina*, 857 F.2d 240, 245 (4th Cir. 1988) (holding that deception that is only "tangentially and incidentally" related to the sale of a security does not satisfy the in connection with requirement). We have found no violation of § 10(b), for example, where "[t]he alleged fraud lies, not in the actual sale of the stock, but rather in defendants' refusal to tender the shares as required by the terms of the [employment] contract." *Hunt*, 852 F.2d at 787. Here, Zandford's securities sales were incidental to his scheme to defraud. Zandford's fraud lay in absconding with the proceeds of the sales. The record contains no suggestion that the sales themselves were conducted in anything other than a routine and customary fashion.

It is the SEC's burden to identify a fraudulent act and a particular sale of securities that would satisfy the in connection with requirement. This it has failed to do. Neither Zandford's inducements to open the brokerage account, nor his failure to inform the Woods that he intended to convert their assets, are sufficiently connected to a particular securities transaction. To take the opening of the account first, there is no allegation that Zandford's inducements influenced any investment decision by the Woods other than to initially open their brokerage account. It is not even alleged that Zandford misled the Woods about the relative merits or value of particular securities. *See Bochicchio v. Smith Barney, Harris Upham & Co., Inc.*, 647 F. Supp. 1426, 1430 (S.D.N.Y. 1986) (holding that where the defendant promised to safely manage plaintiffs' investment account but later made unauthorized sales of plaintiffs' securities and converted the proceeds, the defendant's

fraudulent activity was merely a conversion of funds that did not satisfy the in connection with requirement); *Bosio v. Norbay Securities, Inc.*, 599 F. Supp. 1563, 1566-68 (E.D.N.Y. 1985) (holding that where defendant promised to forward proceeds to plaintiffs after a stock sale but then misappropriated the proceeds, plaintiffs had stated a conversion claim, not a §10(b) violation). Finally, the SEC never contended either in briefing or argument that the Woods' brokerage account was anything other than a discretionary one, in which Zandford could trade securities without first having to gain the Woods' approval.

Where, as here, the inducements to open an investment account did not involve the sale or purchase of any security, any misrepresentations resemble more an actionable state law fraud than a federal securities violation. Zandford's statements did not make any reference to the attributes of a specific security. As such, they are little different from fraudulent misstatements made, for example, in the process of securing a personal loan. The mere "intent to cause a conversion of ownership interests at some uncertain future time and through uncertain means does not bring federal law into play, even though that intent is held at the time a purchase or sale of securities occurs." *Pross v. Katz*, 784 F.2d 455, 459 (2d Cir. 1986); *see also Head v. Head*, 759 F.2d 1172, 1175-76 (4th Cir. 1985) (holding that in order to satisfy the in connection with requirement, the fraud must relate to the securities alleged to satisfy the purchase and sale requirement, and not just to the transaction in its entirety); *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir. 1984) (same).

The SEC next contends that the federal securities fraud laws apply to Zandford's misappropriation of the proceeds in the Woods' account. The SEC has advanced but one case in which a court has held that a broker who sells securities and misappropriates the proceeds has violated the federal securities laws, and that decision provides no analysis to support its holding. *See Henricksen v. Henricksen*, 486 F. Supp. 622, 629 (E.D. Wis. 1980). The SEC relies instead on *United States v. O'Hagan*, 521 U.S. 642, 117 S. Ct. 2199, 138 L.Ed.2d 724 (1997), to support its broad interpretation of the in connection with requirement. Specifically, the SEC argues that *O'Hagan* held that a defendant's misrepresentations do not have to induce investors to engage in a particular securities transaction in order to violate the federal securities laws.

We do not think, however, that *O'Hagan* controls this case. While *O'Hagan* certainly expanded the scope of the in connection with requirement, it did so in a specific context—namely, in those cases where someone traded securities based upon misappropriated confidential information. *O'Hagan* held that an attorney committed fraud in connection with a securities transaction when he misappropriated inside information from his client in order to engage in securities transactions based on this inside information. *O'Hagan*, 521 U.S. at 659, 117 S. Ct. 2199. Important to the Supreme Court's decision was the fact that the misappropriated confidential information had independent value to the client. *Id.* at 652, 656, 117 S. Ct. 2199. The defendant's actions limited the client's opportunity to profit from this information. By contrast, in this case, the Woods did not possess any inside information which would allow them to earn profits in the securities markets.

O'Hagan in fact took pains to limit the extent to which it expanded the scope of the in connection with requirement. It did not graft a generalized prohibition against breaches of fiduciary duty onto the securities laws. *See O'Hagan*, 521 U.S. at 655, 117 S. Ct. 2199. The Court also noted, with apparent approval, the government's contention that § 10(b) would not apply to a case in which a person defrauded a bank into giving him a loan or embezzled cash from another, and then used the proceeds of the misdeed to purchase securities. *Id.* at 656-57, 117 S. Ct. 2199. There would be no violation in such a case because the embezzled proceeds "would have value to the malefactor apart from their use in a securities transaction, and the fraud would be complete as soon as the money was obtained." *Id.* (internal citations omitted). The same logic applies to Zandford's fraudulent conduct. Unlike the defendant in *O'Hagan*, Zandford's goal was not to gain guaranteed profits through the purchase or sale of securities. Rather, his scheme was simply to steal the Woods' assets. *Id.* at 656, 117 S. Ct. 2199. Like the money an embezzler would use to buy securities, the money in the Woods' account had "value to [Zandford] apart from [its] use in a securities transaction." *Id.*

The question is not how Zandford stole the money in the Woods' account. Rather it is whether Zandford engaged in manipulation of a particular security. Zandford's wrongdoing reflects less a federal securities violation and more a state law tort of conversion. The misappropriated proceeds might as well have come from the unlawful sale of a car which the Woods had entrusted to Zandford's care.

The other cases upon which the SEC relies serve to underscore our point. In each of these cases, the defendants made misrepresentations about a particular security that induced another party either to purchase or sell that security. For instance, in *United States v. Naftalin*, 441 U.S. 768, 99 S. Ct. 2077, 60 L.Ed.2d 624 (1979), Naftalin's securities brokers sold particular securities based on Naftalin's false statements that he owned shares of those securities. Likewise, in *Superintendent of Insurance v. Bankers Life & Cas. Co.*, 404 U.S. 6, 9, 92 S. Ct. 165, 30 L.Ed.2d 128 (1971), the defendants, in order to induce a company's Board of Directors to sell certain bonds, falsely told the Board that the company would receive the proceeds of the sale. In *SEC v. Jakubowski*, 150 F.3d 675 (7th Cir. 1998), Jakubowski made false statements on a stock subscription form in order to induce an issuer of securities to accept Jakubowski's offer to buy them. *Id.* at 679. Finally, in *Press v. Chemical Inv. Services Corp.*, 166 F.3d 529, 533 (2d Cir. 1999), the defendants failed to disclose that the funds from a maturing T-bill would not be available on a particular maturity date. This omission meant that the defendants had misrepresented the security's yield, which had affected the plaintiff's decision to purchase the particular security. In contrast to each of these cases, Zandford's statements or omissions were not about a particular security. Nor did his omissions induce the Woods or anyone else to buy or sell a particular stock.

We do not, of course, condone Zandford's misconduct. For his transgressions, Zandford was criminally convicted and he doubtless faces other forms of civil liability and professional sanctions. The fact that Zandford's actions were reprehensible, however, does not

relieve us of the obligation to determine whether his conversion of the Woods' assets violated the federal securities laws. We hold that Zandford's alleged fraudulent activities were not sufficiently connected to a securities transaction to merit liability under sections 17(a) and 10(b), and Rule 10b-5. Rather, the "only connection with federal securities laws is that the funds were converted from a securities investment account." *Smith v. Chicago Corp.*, 566 F. Supp. 66, 70 (N.D. Ill. 1983). The fact that Zandford's conduct as a broker may be within the scope of the securities statutes does not mean that his activities here necessarily constituted fraud in connection with a securities transaction. And while Zandford breached a fiduciary duty to the Woods, the Supreme Court has emphasized that the federal securities laws are not an open-ended breach of fiduciary duty ban. *See O'Hagan*, 521 U.S. at 655, 117 S. Ct. 2199 (citing *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S. Ct. 1292, 51 L.Ed.2d 480 (1977)). In sum, we decline to stretch the language of the securities fraud provisions to encompass every conversion or theft that happens to involve securities. *See Pross*, 784 F.2d at 459. This would be tantamount to endorsing an all-purpose expansion of those statutes which would violate Congress' intent and subsume significant areas of state law.

IV.

For the foregoing reasons, the judgment of the district court is reversed, and the case is remanded with directions to dismiss it.

REVERSED and REMANDED.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil No. AMD 95-2826

SECURITIES & EXCHANGE COMMISSION, PLAINTIFF

v.

CHARLES ZANDFORD, DEFENDANT

[Filed: Mar. 2, 1999]

MEMORANDUM

The Securities and Exchange Commission instituted this action against Charles Zandford, a stock broker, under § 20(b) of the Securities Act of 1933 and §§ 21(d) & (e) of the Securities Act of 1934. In July 1995, Zandford was convicted by a jury in this court of 13 counts of wire fraud in violation of 18 U.S.C. § 1343. In September 1995, he was sentenced to a 52 month period of incarceration. The gravamen of his scheme was to obtain from his two victims in excess of $343,000 for the purpose of operating an investment brokerage account. The jury found, as the indictment alleged and the government's proof at trial established, that Zandford looted the account through fraudulent and unauthorized withdrawals from 1987 through 1991.

On April 3, 1997, the United States Court of Appeals for the Fourth Circuit affirmed Zandford's conviction

and sentence. *United States v. Zandford*, 110 F.3d 62 (4th Cir. 1997) (unreported), 1997 WL 153822 (4th Cir. April 3, 1997).[1]

Plaintiff has filed a motion for summary judgment based on issue preclusion. Zandford has responded with a request to take discovery on the issue of whether his fraudulent scheme was perpetrated "in connection with" securities transactions. I agree with the Plaintiff that the criminal judgment of conviction established that element (and all the elements) of Plaintiff's claim. As one court has observed:

> In a number of cases, the SEC has revoked the registration of brokers who converted money entrusted to them for the purpose of buying stock, or who sold a customer's stock and diverted the proceeds to their own pockets. In these proceedings, such activity has been consistently viewed by the SEC as a violation of Section 10(b) and Rule 10b-5. *Calvert Sec. Corp.*, 35 S.E.C. 141 (1953); *W.F. Coley & Co.*, 31 S.E.C. 722 (1950); *D.S. Waddy & Co.*, 30 S.E.C. 367 (1949). In *SEC v. Kelly*, CCH Fed. Sec. L.Rep. ¶ 90, 497 (N.D. Ill. 1951), the Court

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[1] Zanford has been active litigant before and during his incarceration. *See e.g.*, *Zandford v. National Ass'n of Securities Dealers, Inc.*, 30 F. Supp. 2d 1 (D.D.C. 1998); *Zandford v. National Ass'n of Securities Dealers, Inc.*, 19 F. Supp. 2d 1 (D.D.C. 1998); *Zandford v. National Ass'n of Securities Dealers, Inc.*, 19 F. Supp. 2d 4 (D.D.C. 1998); *Zandford v. Prudential-Bache Securities, Inc.*, 112 F.3d 723 (4th Cir. 1997); *Zandford v. Prudential-Bache Securities, Inc.*, 111 F.3d 963 (D.D.C. 1998) (table); *Zandford v. Prudential-Bache Securities, Inc.*, 1995 WL 507169 (D.D.C. Aug. 15, 1995); *Zandford v. Prudential-Bache Securities, Inc.*, 1994 WL 150918 (D. Md. Feb. 22, 1994); *Zandford v. National Ass'n of Securities Dealers, Inc.*, 1993 WL 580761 (D.D.C. Nov. 5, 1993).

> found a violation of Section 10(b) and Rule 10b-5 where it appeared that the defendant broker took money from customers for security purchases and used it for his own benefit. *See also SEC v. Lawson*, 24 F. Supp. 360 (D. Md. 1938) (conversion of customer's securities by broker defendant violated Section 17 of the Securities Act of 1933); *see generally* 2 Loss, *Securities Regulation* 1185-86 n.9, 1200 n. 41 (1961).

Cooper v. North Jersey Trust Co., 226 F.Supp. 972, 978 (S.D.N.Y. 1964). Accordingly, as a matter of law, Zandford's scheme violated the securities laws invoked here. Moreover, under settled principles of issue preclusion, *see Montana v. United States*, 440 U.S. 147, 153 (1979); *SEC v. Everest Management Corp.*, 466 F. Supp. 167, 172 (S.D.N.Y. 1979), Zandford is precluded from relitigating any of the elements of Plaintiff's civil claim under the securities laws.

Furthermore, despite Zandford's representation that he has no plans to work in the securities industry, Plaintiff is plainly entitled to the equitable relief it seeks as a matter of law, including an injunction and an order for disgorgement. *See Department of Housing & Urban Development v. Cost Control Marketing & Sales Management of Virginia, Inc.*, 64 F.3d 920, 927 (4th Cir. 1995) (citing with approval *S.E.C. v. First City Financial Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989) ("Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws."), *cert. denied sub. nom. Cost Control Marketing & Sales Management of Virginia, Inc. v. Cisneros*, 517 U.S. 1187 (1996).

At sentencing in the criminal case, Judge Nickerson ordered restitution in the amount of $10,800. The Commission shall credit that amount against the disgorgement order entered here. Moreover, I am not persuaded that prejudgment interest is appropriate under the circumstances of this case, in light of the more than four year period of incarceration imposed upon Zandford, during which the Court stayed this litigation. Thus, prejudgment interest is not awarded.

For the reasons stated, the Court will enter, as modified, the Order Proposed by the Plaintiff.

Filed: March 2, 1999 /s/ ANDRE M. DAVIS
ANDRE M. DAVIS
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil No. AMD 959-2826

SECURITIES & EXCHANGE COMMISSION, PLAINTIFF

v.

CHARLES ZANDFORD, DEFENDANT

[Filed: Mar. 2, 1999]

ORDER

In accordance with the foregoing Memorandum, it is this 2nd day of March, 1999, by the United States District Court for the District of Maryland, ORDERED

(1) That Plaintiff's motion for partial summary judgment (Paper # 15-1 and 15-2) is GRANTED IN PART and Defendant's motion for discovery and to extend time (Paper # 16 and # 18) are DENIED; and it is further ORDERED

(2) That the Clerk shall REOPEN THIS CASE, ENTER THE JUDGMENT ORDER ATTACHED HERETO AS A FINAL JUDGMENT WITHIN THE MEANING OF FED. R. CIV. P. 58, AND CLOSE THIS CASE; and it is further ORDERED

(3) That the Clerk shall TRANSMIT a copy of the foregoing Memorandum, this Order and the accompanying "Final Partial Judgment" to the attorneys for Plaintiff and to Defend, pro se.

/s/ ANDRE M. DAVIS
ANDRE M. DAVIS
United States District Judge

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil No. (AMD) 95-CV-2826

SECURITIES & EXCHANGE COMMISSION, PLAINTIFF

v.

CHARLES ZANDFORD, DEFENDANT

[Filed: Mar. 2, 1999]

FINAL PARTIAL JUDGMENT

It appearing to this Court that Plaintiff Securities and Exchange Commission ("Commission"), having duly commenced this action by filing its Complaint ("Complaint") against defendant Charles Zandford ("Zandford"), defendant Zandford having filed a reply thereto; the Commission having moved this Court for an Order granting partial summary judgment, permanent injunction, disgorgement (with prejudgment interest) against defendant Zandford; the parties having submitted memoranda and other materials in support of and in opposition to the motion, the Court having jurisdiction over the parties and the subject matter of this action, and the Court being fully advised of the premises, the Court finds the following:

On July 25, 1995, a jury sitting in the United States District Court for the District of Maryland convicted Zandford of wire fraud in violation of 18 U.S.C. § 1343. (*U.S. v. Charles Zandford*, Criminal No. WN-94-0165).

The Court further finds that defendant Zandford's criminal conviction was based on the same facts alleged by the Commission against Zandford in its Complaint concerning misappropriations, and that Zandford is therefore collaterally estopped from relitigating the facts underlying his conviction.

The Court further finds that defendant Zandford's conviction establishes that he has engaged in violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

The Court further finds that there is a reasonable likelihood that defendant Zandford will violate these provisions of the federal securities laws in the future.

The Court further finds that the pleadings and other materials on file show that there is no genuine issue as to any material fact underlying the Commission's claim against defendant Zandford based upon misappropriations, the Commission is entitled to a judgment against Zandford on this claim as a matter of law under Fed. R. Civ. P. 56(c), and that an injunction should be issued against defendant Zandford based on these findings.

The Court further finds that defendant Zandford received $343,000 as a result of his illegal misappropriation of funds held in a brokerage account; and that he should be ordered to disgorge this amount, plus pay prejudgment interest of $309.406 [*sic*] thereon.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the Commission's Motion for Partial Summary Judgment, Permanent Injunction, and Disgorgement plus prejudgment interest against defendant Zandford is hereby granted.

II.

IT IS FURTHER ORDERED THAT:

Zandford, his agents, officers, servants, employees, attorneys, and those persons in active concert or participation with them, directly or indirectly, singly or in concert, who receive actual notice of this Order by personal service or otherwise, are permanently enjoined from making use of any means or instruments of transportation or communication in interstate commerce, or any means or instrumentality of interstate commerce, or of the mails, or any facility of any national securities exchange, in connection with the purchase or sale of any security to:

(a) employ any device, scheme or artifice to defraud;

(b) make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading; or

(c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;

in violation of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, thereunder.

III.

IT IS FURTHER ORDERED THAT:

Zandford shall pay disgorgement in the amount of $343,000 to the Clerk of the Court within thirty (30) days of the entry of this Order. Payment shall be made consistent with instructions to be provided by the Commission. Said disgorgement funds shall be distributed in accordance with a plan of disgorgement agreeable to the Commission and the Court.

February 25, 1999 /s/ Andre M. Davis
Date United States District Judge

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

Civil Action No. AMD-95-2826

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

CHARLES ZANDFORD, DEFENDANT

[Filed: Sept. 22, 1995]

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission") alleges for its Complaint the following:

1. Defendant Charles Zandford ("Zandford") has engaged in acts, transactions, practices and courses of business which constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77q(a), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, thereunder.

JURISDICTION AND VENUE

2. The Commission brings this action pursuant to Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), and Sections 21(d) and 21(e) of the Exchange Act, 15 U.S.C. 78u(d) and 78u(e), to enjoin such acts, transactions,

practices and courses of business alleged herein, and for other relief.

3. The Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act, 15 U.S.C. 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. 78aa.

4. Venue is proper in this district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. 78aa, inasmuch as certain of the acts and practices constituting the violations alleged herein occurred within the District of Maryland and elsewhere.

5. Unless permanently restrained and enjoined by this Court, defendant Zandford will continue to engage in the same and similar transactions and courses of business alleged herein.

THE DEFENDANT

6. Charles Zandford is a resident of Maryland. During all times relevant to this Complaint, Zandford was a stockbroker in the Bethesda, Maryland branch office of Dominick and Dominick, Inc. ("Dominick"), a broker-dealer registered with the Commission.

7. On July 24, 1995, Zandford was found guilty by a jury sitting in the United States District Court for the District of Maryland on thirteen counts of wire fraud, based on the conduct described in this Complaint. (*United States* v. *Zandford*, Criminal Action No. WN-94-0165).

FACTS

Summary

8. Between November 1987 and August 1990, while employed as a stockbroker at Dominick, Zandford engaged in a scheme to defraud his largest brokerage customer, William R. Wood ("Wood"), of his life savings.

9. Wood, then an elderly man with physical and mental disabilities, held a joint account at Dominick with his daughter, Diane Wood Okstulski ("Okstulski"). (This account is referred to hereinafter as the Wood/Okstulski account.) Okstulski is mentally retarded and suffers from various psychological disorders.

10. Zandford misappropriated approximately $343,000 from Wood and Okstulski by liquidating, without their knowledge and consent, securities in their Dominick account, as well as mutual fund shares they held outside of the Dominick account. Zandford also received approximately $24,000 in commissions by excessively trading securities in the Wood/Okstulski account.

Background

11. In September 1987, Wood opened a joint account with Zandford at Dominick on behalf of Okstulski and himself, making an initial deposit of approximately $130,000. Wood's stated investment objectives for the account were "safety of principal and income."

12. In March 1988, Wood gave Zandford an additional $289,000 to deposit in the Wood/Okstulski account.

13. At the time Wood opened his brokerage account with Zandford, he was in poor mental and physical health. He had been on total disability from the government due to a head injury suffered twenty-three years earlier. Wood's physical and mental condition deteriorated during the period alleged herein. In April 1988, Wood suffered a stroke and was hospitalized. Wood spent the majority of the remainder of his life in nursing homes.

14. Wood died in a nursing home in December 1991, at the age of 76. At the time of Wood's death, there were no securities or funds remaining in the Wood/Okstulski account, as a result of Zandford's fraudulent conduct described below.

Misappropriation

15. Between May 1988 and June 1990, Zandford misappropriated approximately $343,000 from Wood and Okstulski in the manner set forth below.

16. Zandford's fraudulent scheme began in May 1988, shortly after Wood was hospitalized as a result of his stroke. Between May and June 1988, Zandford, without the prior knowledge or consent of Wood and Okstulski, issued three checks to himself totalling $41,000. The checks were drawn on a joint mutual fund account held by Wood and Okstulski outside of their Dominick account, and the funds represented therein were obtained through the sale of mutual fund shares in that account.

17. In July 1988, Zandford, without the prior knowledge or consent of Zandford, sold three securities in the Wood/Okstulski account for a total of $145,000. Zandford then obtained a check from Dominick in that amount and deposited it into a bank account under his control.

18. Between July 1989 and June 1990, Zandford misappropriated an additional $157,000 from Wood and Okstulski. On ten occasions during this period, Zandford caused mutual fund shares held by Wood and Okstulski in mutual fund accounts held outside of their Dominick account to be sold, and the resulting proceeds to be paid into the Wood account at Dominick. Zandford obtained approximately $111,000 in this manner. Zandford generated the remaining approximately $46,000 by selling securities in the Wood/Okstulski account. As the above proceeds were deposited into the Wood/Okstulski account, Zandford caused Dominick to issue checks made payable to Wood and Okstulski in amounts which corresponded with these transactions. Zandford then obtained the checks and deposited them into one of three bank accounts in his name or under his control. Zandford acquired the above funds without the prior knowledge or consent of Wood and his daughter.

19. Zandford used at least $64,000 of the misappropriated funds to purchase securities for his girlfriend's brokerage account at Dominick. All of the funds deposited in Zandford's girlfriend's account were later paid to Zandford at his request. Zandford used the remainder of the misappropriated funds to pay personal expenses including credit card debt and bank loans.

Excessive Trading

20. In addition to the above described misappropriation, Zandford also excessively traded securities in the Wood/Okstulski account.

21. Between November 1987 and August 1988, and February 1990 and July 1990, Zandford made all trading decisions in the Wood/Okstulski account.

22. Between November 1987 and August 1988, Zandford, with the intent to deceive, excessively traded securities in the Wood/Okstulski account. As a result of this conduct, Zandford generated gross commissions of approximately $37,000, of which he received approximately $23,000.

23. Between February 1990 and July 1990, Zandford, with the intent to deceive, excessively traded securities in the Wood/Okstulski account. As a result of this conduct, Zandford generated gross commissions of approximately $3,000, of which he received approximately $1,000.

CLAIM

Violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder

24. Paragraphs 1 through 23 are realleged and incorporated herein by reference.

25. From in or about 1987 through in or about 1991, defendant Zandford, in connection with the offer, purchase or sale of securities, directly and indirectly, by use of the means and instruments of transportation or

communication in interstate commerce, or the means and instrumentalities of interstate commerce, or the mails, or the facilities of a national securities exchange:

(a) employed devices, schemes or artifices to defraud;

(b) obtained money or property by means of, and made, untrue statements of material fact, or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) engaged in acts, transactions, practices, or courses of business which operated as a fraud and deceit upon offerees, purchasers or sellers of securities.

26. As part of and in furtherance of this conduct, defendant Zandford misappropriated funds from Wood and Okstulski, and excessively traded securities in the Wood account, as described in this Complaint.

27. By reason of the foregoing, defendant Zandford violated Section 17(a) of the Securities Act, 15 U.S.C. 77q(a); Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b); and Rule 10b-5, 17 C.F.R. 240.10b-5, thereunder.

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue an injunction permanently enjoining defendant Zandford, his agents, officers, servants, employees, attorneys, and those persons in active concert or participation with them, directly or indirectly, singly or in

concert, from violations of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a); Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b); and Rule 10b-5, 17 C.F.R. 240.10b-5, thereunder.

II.

Issue an order directing defendant Zandford to make disgorgement of any unlawfully obtained proceeds which he received as a result of the fraudulent conduct described in this Complaint, together with prejudgment interest.

III.

Grant such other and further relief as this Court may deem just and equitable.

Respectfully submitted,

/s/ R.A. Levan
Richard A. Levan, Bar #11477
Michael J. Newman
Deborah E. Siegel

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DATED: SEPTEMBER 19, 1995

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 95-5816

UNITED STATES OF AMERICA, PLAINTIFF-APPELLEE

v.

CHARLES ZANDFORD, DEFENDANT-APPELLANT

[Argued: Jan. 30, 1997]

[Decided: Apr. 3, 1997]

Before: RUSSELL and WILKINS, Circuit Judges, and HERLONG, United States District Judge for the District of South Carolina, sitting by designation.

OPINION

PER CURIAM:

Zandford appeals his conviction and sentence of 52 months imprisonment for committing thirteen counts of wire fraud. Zandford contends the Government failed to present sufficient evidence of wire fraud to sustain his convictions; and that the district court erred in admitting the testimony of four Government witnesses. Because each of Zandford's grounds for appeal is meritless, we affirm.

I.

Charles Zandford worked as a stockbroker for a brokerage firm. which had offices in Bethesda, Maryland, and New York, New York, from May 1987 through February 1991. He met William Wood in November 1987, and solicited Wood to invest with him. Wood, 71 years old at the time, opened a joint investment account with Zandford. The account was titled in Wood's name and that of his daughter, Diane Okstulski, who suffered from a multiple personalities disorder. Within four months after their first meeting, Zandford persuaded Wood to entrust him with $419,255 to "conservatively invest." Nineteen months later, all of Wood's money was gone.

In January 1991, the National Association of Security Dealers ("NASD") inadvertently discovered that Zandford had systematically transferred money on over twenty-six separate occasions from Wood's and Diane's investment account to accounts either controlled by Zandford or in Zandford's name. When confronted about the transfers one month later, Zandford acknowledged that Wood and Okstulski (hereinafter "the Woods") had transferred money to him. He explained that pursuant to three agreements he had entered into with the Woods in 1988 and 1989, they gave him: $100,000 under a personal services agreement for services he rendered to them as an overseer of their personal and medical needs; $150,000 to invest in and operate a vintage car restoration business; and $140,000 as an unsecured personal loan for reasons undisclosed. The remaining money he allegedly spent on behalf of the Woods. Mr. Wood died in 1991.

In April 1995, a federal grand jury issued a superseding indictment against Zandford for thirteen counts of wire fraud in violation of 18 U.S.C. § 1343. The first count related to money Zandford obtained from selling the Woods' shares in a mutual fund. The remaining counts related to twelve separate withdrawals Zandford made from the Woods' joint investment account. After a three-week trial, a jury convicted Zandford on all counts. He received a sentence of 52 months imprisonment.

II.

Zandford contends that the evidence is insufficient to support his wire fraud convictions. When reviewing challenges to sufficiency of the evidence, we determine whether any rational trier of fact could have found the essential elements of the charged offenses beyond a reasonable doubt.[1] Assuming the jury weighed the evidence, resolved all conflicts in the testimony, and drew all reasonable inferences from the facts, we consider all of the evidence in the light most favorable to the government.[2]

To prove Zandford violated the wire fraud statute, the Government had to establish: (1) the existence of a scheme to defraud and (2) use of interstate wire communications to facilitate the scheme.[3]

First, Zandford contends there was insufficient evidence to find that he had engaged in a scheme to

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[1] *Jackson* v. *Virginia*, 443 U.S. 307, 319 (1979).

[2] *Id.*

[3] 18 U.S.C.A. § 1343 (West Supp. 1997): *United States* v. *ReBrook*, 58 F.3d 961, 966 (4th Cir. 1995) (citation omitted).

defraud. He claims the Woods willfully transferred their money to him via three lawfully-executed agreements. He also maintains that the Government's case against him was flawed because it failed to use relevant contract law to invalidate the agreements. The Government's burden, however, was not to disprove Zandford's defense. Rather the Government's obligation was to place enough evidence before the jury to prove beyond a reasonable doubt that Zandford engaged in a scheme to defraud the Woods.

The term "scheme to defraud" means "any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations or promises."[4] It includes fraudulent schemes based on false statements or factual misrepresentations.[5] Thus, with respect to the alleged agreements, it was sufficient for the Government to cast doubt upon the validity of the agreements or demonstrate that the agreements themselves manifested the scheme by which Zandford tried to "legitimize" the wholesale theft of the Woods' money.

The Government presented ample direct and circumstantial evidence showing that Zandford had engaged in a scheme to defraud the Woods. It showed that: (1) Zandford had systematically transferred large sums of money from the Woods' account to his own accounts over a nineteen month period; (2) prior to November 1987, the Woods had no relationship with Zandford; (3) Zandford, and not the Woods, benefitted from the money transfers; (4) the Woods were vulnerable victims due to their physical and mental limitations; (5) the personal services agreement, the loan, and the vintage

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[4] *Carpenter* v. *United States*, 184 U.S. 19, 27 (1987).

[5] *See*, *McNally* v. *United States*, 483 U.S. 350, 359 (1987).

car restoration business were not only contrary to the Woods' stated investment objectives, but they violated the rules of NASD and those of Zandford's employer that prohibited brokers from engaging in such arrangements; and (6) vehicles owned as part of the vintage car restoration business were titled in the name of Zandford's girlfriend as opposed to the Woods' names. Additional evidence showing a scheme to defraud included Zandford's failure to disclose to his employer the existence of the agreements and personal loans; his failure to report on his taxes or bank loan applications that he received income from acting as the personal representative; and his failure to disclose on his taxes his involvement in a vintage car restoration business. Zandford's contention that there is insufficient evidence supporting that he had engaged in a scheme to defraud the Woods is meritless.

Zandford also contends that there was insufficient evidence to find that he used wire transfers in furtherance of a scheme to defraud. This contention is also without merit. On behalf of the Government, the branch manager and the compliance officer of the brokerage firm testified that every time money was withdrawn from the Woods' account a wire communication was used between the branch office in Bethesda, Maryland, where Zandford worked, and New York New York, to verify the availability of funds and permit the transfer. Additionally, computer-monitored money line documents showed that Zandford used a wire communication between Maryland and New York for nine of the thirteen withdrawals he made from the Woods' joint account.

Given the foregoing evidence, we hold that any rational trier of fact could have found the essential ele-

ments of wire fraud beyond a reasonable doubt. We affirm Zandford's thirteen convictions for wire fraud.

III.

Next, Zandford contends the district court erred in admitting the testimony of four government witnesses. We review evidentiary rulings for abuse of discretion.[6]

First, Zandford contends that the Government used the hearsay testimony of two doctors and a nurse in order to establish Mr. Wood's incompetence during the time period in which Zandford entered into the agreements with the Woods. The record reveals both doctors testified as expert witnesses and treating physicians. A neurologist testified that Mr. Wood was his patient during 1988-91 and was virtually blind, completely incompetent, and medically disabled. The other doctor, a general physician, corroborated much of the neurologist's testimony, and stated that from January 1989 to February 1990, Mr. Wood suffered from dementia. The doctors' proffered testimony as to Mr. Wood's medical condition during the relevant time period was admissible under Federal Rule of Evidence 703, "Bases of Opinion Testimony by Experts," and under a hearsay exception, Federal Rule of Evidence 803(4), "Statements for purposes of medical diagnosis or treatment."

Zandford also contends that the district court erred in allowing the Government to admit into evidence the nursing notes of the nurse assigned to care for Mr. Wood in a nursing home from January 1990 to June 1991. The notes characterized Mr. Wood's medical con-

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[6] *United States* v. *Heater*, 63 F.3d 311, 320 (4th Cir. 1995).

dition as "senile dementia," and the nurse testified that her observations of Mr. Wood were consistent with that characterization. Pursuant to Federal Rule of Evidence 803(6), "Records of regularly conducted activity," these notes were properly admitted as they were kept in the regular course of business by the nursing staff at the nursing home.

Second, Zandford contends that the district court erred in allowing a psychologist to testify regarding Okstulski's mental capacity during the relevant time period. This testimony was also properly admitted under Federal Rules of Evidence 703 and 803(4) as discussed above.

The district court did not abuse its discretion in admitting the testimony of the doctors, the psychologist, or the nurse's notes.[7]

IV.

For the foregoing reasons Zandford's conviction and sentence for thirteen counts of wire fraud is

AFFIRMED.

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[7] Zandford raises numerous other issues which we hold to be meritless.

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

CRIMINAL NO. WN-94-0165
(Wire Fraud, 18 U.S.C. § 1343)

UNITED STATES OF AMERICA

v.

CHARLES ZANDFORD

[Filed: Apr. 6, 1995]

SUPERSEDING INDICTMENT

The Grand Jury for the District of Maryland charges that:

1. At all times pertinent to this Indictment:

(a) Dominick & Dominick (hereinafter "Dominick") was a securities broker/dealer located at 90 Broad Street, New York, New York and maintained a branch office located at 7200 Wisconsin Avenue, Suite 710, Bethesda, Maryland; and

(b) CHARLES ZANDFORD was a general securities broker/representative employed by Dominick & Dominick in its Bethesda, Maryland branch office.

The Scheme and Artifice to Defraud

2. Beginning in or about November of 1987 and continuing, thereafter, to in or about September of 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, did devise and intend to devise a scheme and artifice to defraud and to obtain money and property from William R. Wood and Diane Wood Okstulski by means of false and fraudulent pretenses, representations, and promises.

3. It was a part of the said scheme and artifice to defraud that in November of 1987, CHARLES ZANDFORD agreed to become the securities broker/representative for William R. Wood and his daughter Diane Wood Okstulski. Pursuant to this agreement, in November of 1987, William R. Wood and Diane Wood Okstulski opened a joint investment account at Dominick & Dominick in Bethesda, Maryland.

4. It was a further part of the said scheme and artifice to defraud that between the period of November of 1987 and March of 1988, William R. Wood and Diane Wood Okstulski, entrusted CHARLES ZANDFORD with $419,255 to be held in the joint investment account at Dominick & Dominick. By September 28, 1990, CHARLES ZANDFORD caused the balance in the joint investment account to be depleted.

5. It was a further part of the said scheme and artifice to defraud that CHARLES ZANDFORD caused checks to be issued against the security positions of William R. Wood and Diane Okstulski and made payable to CHARLES ZANDFORD, thereby causing their securities to be liquidated. During the period of March of 1988 through September of 1990, CHARLES ZANDFORD caused checks in the amount of $346,292.78 to be issued from the joint investment account of William R. Wood and Diane Okstulski. CHARLES ZANDFORD then made personal uses of this money to,

among other things, pay credit cards, personal loans and purchase automobiles.

6. It was a further part of the said scheme and artifice to defraud that CHARLES ZANDFORD sold securities in William R. Wood and Diane Wood Okstulski's joint investment account, deposited a check made payable to William Wood from the Department of Labor, Office of Workmen's Compensation into the joint investment account and then made personal use of the money.

Executing The Scheme

7. On or about March 8, 1988 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice to defraud, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the purchase of mutual fund shares in Colonel Tax-Exempt Insured Mutual Fund on behalf of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT II

The Grand Jury for the District of Maryland further charges that:

1. The allegations contained in Paragraphs 1 through 6 of Count I are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about August 4, 1988, in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York, in connection with the withdraw of $145,000.00 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT III

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about July 18, 1989 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the withdraw of $13,156.70 from the joint invest-

ment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT IV

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about August 14, 1989 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the withdraw of $15,000.00 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT V

The Grand Jury for the District of Maryland further charges that:

1. The allegations contained in Paragraphs 1 through 6 of Count I are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about September 15, 1989 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the withdraw of $20,012.19 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT VI

The Grand Jury for the District of Maryland further charges that:

1. The allegations contained in Paragraphs 1 through 6 of Count I are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about November 24, 1989 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the withdraw of $20,016.28 from the

joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT VII

The Grand Jury for the District of Maryland further charges that:

1. The allegations contained in Paragraphs 1 through 6 of Count I are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about December 28, 1989 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the withdraw of $5,012.66 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT VIII

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about January 19, 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication, signs, signals and sounds, that is, a wire transfer communication between Maryland and New York in connection with the withdraw of $5,000.00 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT IX

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs l through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about January 25, 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication between Maryland and New York in connection with the withdraw of $15,000.00 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT X

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about February 13, 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication between Maryland and New York in connection with the withdraw of $28,782.72 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT XI

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about March 5, 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication between Maryland and New York in connection with the withdraw of $19,171.21 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT XII

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about April 23, 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication between Maryland and New York in connection with the withdraw of $8,134.50 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U.S.C. § 1343

COUNT XIII

And the Grand Jury for the District of Maryland further charges:

1. The allegations contained in Paragraphs 1 through 6 of Count One are realleged and incorporated herein as though fully set out in this Count of the Superseding Indictment.

2. On or about September 6, 1990 in the State and District of Maryland,

CHARLES ZANDFORD

the defendant herein, for the purpose of executing and attempting to execute the aforesaid scheme and artifice, did knowingly cause to be transmitted in interstate commerce by means of a wire communication between Maryland and New York in connection with the withdraw of $2,864.13 from the joint investment account of William R. Wood and Diane Wood Okstulski.

18 U. S. C. § 1343

/s/ LYNNE A. BATTAGLIA
LYNNE A. BATTAGLIA
UNITED STATES ATTORNEY

[Illegible]
FOREPERSON

April 6, 1995
DATE

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 99-1733
CA-95-2826-AMD

SECURITIES & EXCHANGE COMMISSION,
PLAINTIFF-APPELLEE

v.

CHARLES ZANDFORD, DEFENDANT-APPELLANT

[Filed: Mar. 26, 2001]

On Petition for Rehearing and Rehearing En Banc

The appellee's petition for rehearing and rehearing en banc was submitted to this Court. As no member of this Court or the panel requested a poll on the petition for rehearing en banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and rehearing en banc is denied.

For the Court,

/s/ Patricia S. Connor
CLERK

APPENDIX G

STATUTORY APPENDIX

1. Section 78j of Title 15 of the United States Code provides in relevant part:

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. Section 240.10b-5 of Title 17 of the Code of Federal Regulations provides:

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to

make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.