

**UNITED STATES DISTRICT COURT  
DISTRICT OF CONNECTICUT**

|                                |   |                  |
|--------------------------------|---|------------------|
| SECURITIES AND EXCHANGE        | : |                  |
| COMMISSION,                    | : |                  |
|                                | : |                  |
| Plaintiff                      | : |                  |
|                                | : | CIVIL ACTION NO. |
| v.                             | : | 3:03CV1524 (MRK) |
|                                | : |                  |
| BLAKE A. PRATER and            | : |                  |
| WELLSPRING CAPITAL GROUP, INC. | : |                  |
|                                | : |                  |
| Defendants.                    | : |                  |

**RULING AND ORDER**

This case began in the fall of 2003 as an enforcement action against Blake A. Prater and his company, Wellspring Capital Group, Inc. (“Wellspring”) by the Securities and Exchange Commission (“SEC”), which alleged that Defendants had violated various provisions of the Securities Act of 1933 (the “1933 Act”), the Securities Exchange Act of 1934 (the “1934 Act”) and SEC Rule 10b-5, by operating a pyramid scheme involving the fraudulent offer and sale of unregistered securities. The Court has already issued several opinions relating the facts underlying this case, including an opinion granting the SEC’s motion for a preliminary injunction prohibiting Defendants from continuing to violate the securities laws and freezing certain assets and bank accounts associated with Defendants' activities. *See SEC v. Prater*, 296 F. Supp. 2d 210 (D. Conn. 2003); *SEC v. Prater*, 2003 WL 22937722 (D. Conn. Oct. 17, 2003); *SEC v. Prater*, 289 F. Supp. 2d 39 (D. Conn. 2003). The Court assumes familiarity with its prior decisions in this case.

After several aborted efforts to defend against the SEC's charges, Defendants eventually entered into settlement negotiations with the SEC, and ultimately settled the claims against them. Presently before the Court are a number of motions, objections and requests relating to the implementation of the settlement. Before turning to those matters, however, a brief summary of the key settlement documents and events is in order.

## I.

In July 2004, Defendants and the SEC filed a Consent to Final Judgment of Permanent Injunction, Disgorgement and Other Relief [doc. # 88]. The Consent bound Defendants to entry of a final judgment against them and also committed Defendants to cooperate with and assist any receiver that might be appointed to identify investors who had lost money as a result of Defendants' scheme. On August 16, 2004, in response to an application by Defendants and the SEC, the Court entered a Final Judgment of Permanent Injunction, Disgorgement and Other Relief (the "Final Judgment") [doc. # 90].

The Final Judgment permanently enjoined Defendants from violating various provisions of the 1933 Act and 1934 Act, ordered Defendants jointly and severally to pay disgorgement in the amount of \$6 million (together with pre-judgment interest of \$24,258) and imposed a civil monetary penalty of \$120,000 on Prater and \$600,000 on Wellspring. The Final Judgment ordered the funds held in accounts that had been frozen as a result of the preliminary injunction to be paid into the Court's registry and directed the SEC to propose by September 17, 2004 a plan to distribute those funds "to repay the investors' net investment losses and to seek the appointment of a receiver who shall administer the distribution plan subject to the Court's

approval.” Final Judgment § VIII. At the time, the SEC anticipated that investors would eventually receive a significant portion, though not all, of their net cash loss, then estimated to be in the neighborhood of \$6 million. *See* Plaintiff’s Memorandum in Support of Proposed Settlement [doc. # 89] at 4. However, the Final Judgment provided that in the event the funds recovered by the SEC were insufficient to satisfy all of Prater’s and Wellspring’s disgorgement and civil penalty obligations, Defendants would each remain obligated to pay any deficiency. Final Judgment § IX.

In September 2004, the SEC filed its proposed distribution plan. Defendants were given notice and an opportunity to comment on the plan, but provided no comment. Accordingly, in October 2004, the Court entered an Order for Approval of Distribution Plan (the “Distribution Plan”) [doc. # 97]. Before approving the Distribution Plan, the Court had entered an Order for Appointment of Receiver (the “Receiver Order”) [doc. # 85], which had appointed Lewis K. Wise, Esq. as receiver (the “Receiver”) and had authorized the Receiver, among other things, to identify the persons who had participated in Wellspring’s investment programs and calculate their losses. The Receiver Order also required Prater and Wellspring to cooperate with the Receiver and to turn over all books and records. Receiver Order [doc. # 85] ¶¶ 2(f)-(g).

The Distribution Plan made the Receiver responsible for, among other things: maintaining an escrow fund (the “Escrow Fund) to be established with the funds from the Court registry plus any other funds obtained by the Receiver from Wellspring or Prater or from their assets; providing notice to potential Eligible Claimants (defined below) of the Escrow Fund; making a final determination as to the identity of Eligible Claimants and the amount of their Net Cash Loss ( also defined below); distributing money from the Escrow Fund to Eligible

Claimants; and submitting periodic reports to the Court. An Eligible Claimant was defined as a person who:

- a. participated in one or more of Wellspring's investment programs through a transfer of funds that were deposited into a bank account controlled by Prater and/or Wellspring located in the United States;
- b. sustained a Net Cash Loss as a result of participating in Wellspring's investment programs; and
- c. has not compromised any claims against defendants Prater and Wellspring arising from participation in Wellspring's investment programs.

Distribution Plan [doc. # 97] § A.2. According to the Distribution Plan, a Net Cash Loss occurred if the "total amount which the person paid directly or indirectly to Wellspring exceed[ed] the total amount which the person received directly or indirectly from Wellspring."

*Id.* The Distribution Plan also set forth a timetable for identifying Eligible Claimants, for providing notice of their right to submit a claim, for evaluating claims and making preliminary and final determinations of the amount due, if any, and for making distributions to Eligible Claimants. Finally, the Distribution Plan provided that the "Receiver's determination as to a person's status as Eligible Claimant and the amount of such person's Net Cash Loss shall be final, and the Court will not hear any appeals from such determination." Distribution Plan [doc. # 97] § F.18.

The Receiver began the process of identifying Eligible Claimants promptly upon appointment. The Court refers the reader to the Receiver's reports to the Court [doc. ## 98, 125] for further details regarding the Receiver's efforts to identify Eligible Claimants and to recover funds to repay their losses. As the Receiver has previously documented in his reports, despite Prater's obligation to assist the Receiver and to provide the Receiver with information needed to

identify Eligible Claimants, he did no such thing. Moreover, even though Prater has always maintained that the funds on hand were more than sufficient to repay all of his investors, it became apparent early on that the funds held by the Receiver would be well short of the amount necessary to compensate investors for all of their losses. Ruling and Order dated April 21, 2005 [doc. # 121].

In making his determinations as to Eligible Claimants and the extent of their Net Cash Losses, the Receiver has utilized a computer database created by the Internal Revenue Service and Federal Bureau of Investigation (FBI) as a part of their ongoing criminal investigation of Prater and Wellspring. The database, which has been provided to Prater, contains, in essence, virtually all of the banking records of Wellspring's U.S. bank accounts, and it was created from the banking records provided by Wellspring's banks pursuant to FBI subpoenas. The database reflects all monies paid into Wellspring's U.S. bank accounts by investors and all monies paid to investors by Wellspring from its U.S. accounts. The database has made it possible for the Receiver to calculate the net loss, if any, incurred by each claimant. *See* Receiver's Response to Defendant Prater's Supplemental Memorandum in Support of Defendant's Motion to Set Aside Determination [doc. # 147] at 4-5 ("Receiver's Response II").

Notice of the claims process, along with a claim form, was sent to all investors whom the Receiver was able to identify. In addition, the notice was posted on the SEC's website and published in *USA Today*. After dissemination and publication of the claims process, the Receiver received approximately 2,200 claims. On March 23, 2005, the Receiver mailed out 1,679 preliminary net loss determinations to domestic claimants who were not Wellspring sales representatives or agents. *See* Receiver's Response to Defendant Prater's Motion to Set Aside

Determinations [doc. # 127] at 3-4 (“Receiver’s Response I”). The letter to the claimants advised them of their right to object to the Receiver’s preliminary net loss determination by setting forth their objection in a letter to the Receiver, along with supporting documentation, within 30 days. Receiver's Response II [doc. # 147] at 6. Despite the fact that a large percentage of claimants received net loss determinations that were less than the amounts sought, only 60 claimants (approximately 3.5% of the 1,679 domestic claimants) disputed the Receiver’s preliminary net loss determinations. Receiver's Response I [doc. # 127] at 4. Of the 60 objections, the Receiver found that 27 were well-founded and adjusted their net loss determinations accordingly. *Id.* at 4. The total amount of domestic claims exceeds \$6.185 million. Second Report of Receiver [doc. # 125] at 2.

In addition to the domestic claimants, the Receiver sent out preliminary determination letters to 592 international claimants – that is, individuals with addresses outside the United States. Of these, the Receiver deemed 336 ineligible to receive payment from the Escrow Fund because there was no evidence that the funds they transferred to Wellspring were deposited in to a bank account controlled by Prater or Wellspring that was located in the United States, as required by the Distribution Plan. Second Report of Receiver [doc. #125] at 2 ¶ 3. The remaining international claimants received preliminary loss determinations in the same manner as the domestic claimants. The international claims, which have not yet been finalized, total approximately \$960,000. *Id.* at 3.

As a consequence, the total of all eligible losses will likely exceed \$7 million. As of May 6, 2005, the Receiver reported that he had cash on hand of \$4.194 million and was continuing to take steps to augment the Escrow Fund through a sale of the Prater residence and liquidation of

other assets of Defendants. Second Report of Receiver [doc. # 125] at 1. Therefore, it appears that, as predicted by the Receiver, there will in fact be a large shortfall between the amount of money currently on hand to repay losses and the amount of all verified losses.

## II

The following motions are currently pending before the Court: (1) Defendants' Motion to Set Aside the Receiver's Determination of Eligible Claimants and Net Cash Losses [doc. # 123]; the Receiver's Second Request that the Court Require Defendant Prater to Provide Requested Information [doc. # 132] (the "Receiver's Second Request"); the Receiver's Proposed Budget for Quiet Title Action [doc. # 133] regarding Prater's residence; Motion by John Kaiser to Withdraw as Attorney for Defendants [doc. # 136] and Motion by Kit Barron Bradshaw to Withdraw as Attorney for Defendants [doc. # 144]. The Court will address these motions in turn.

### A.

In their Motion to Set Aside the Receiver's Determination of Eligible Claimants and Net Cash Losses, Defendants ask the Court to set aside the Receiver's loss determinations on a variety of grounds. The Court provided an opportunity for all parties to brief the issues raised by Defendants' motion and also provided Prater an opportunity to submit two briefs *pro se* relating to his claims. *See* Memorandum in Support re. Motion to Set Aside Receiver's Determination [doc. # 134]; Supplemental Memorandum in Support of Motion to Set Aside Receiver's Determination [doc. # 139]. For the reasons stated below, the Court DENIES Defendants' Motion to Set Aside the Receiver's Determinations.

In essence, Defendants' arguments fall into two categories. First, they point to several

errors that they uncovered in the Receiver's determinations and argue from those errors that the process for determining losses was fundamentally flawed and the Receiver's determinations are therefore unreliable. Second, Defendants take issue with the Receiver's inclusion of so-called "e-gold" and "e-bullion" transactions in making net loss determinations. Neither argument has any merit.

First, a small number of claim errors identified by Defendants after months of examination of the Receiver's database and determinations does not undermine the claims determination process, as Defendants hoped it would. To the contrary, the relatively small number of errors – six inaccurate determinations that appear to be mostly minor clerical errors – serves to confirm the reliability of the Receiver's methodology and processes. *See* Motion to Set Aside the Receiver's Determination of Eligible Claimants and Net Cash Losses [doc. # 123] Ex. A-F. Where appropriate, the Receiver has already made any corrections warranted by Defendants' objections. *See* Receiver's Response I [doc. # 127] Ex. A-F. Certainly, the few isolated errors identified do not even remotely provide a basis for questioning the Receiver's overall methodology or setting aside the entire claims determination process, as Defendants suggest.<sup>1</sup>

Second, the Receiver correctly included e-gold and e-bullion transactions in making his

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<sup>1</sup> Under the terms of the Distribution Plan, the "Receiver's determination as to a person's status as Eligible Claimant and the amount of such person's Net Cash Loss shall be final, and the Court will not hear any appeals from such determination." Distribution Plan § F.18. However, all parties agreed that the Court could entertain challenges by Defendants to the overall methodology utilized by the Receiver in determining claims. The Court has, therefore, limited its review to the Receiver's methodology and processes and the Court has not entertained objections to individual determinations of claimant losses by the Receiver.

Net Cash Loss determinations. In an effort to reduce the amount of losses for which they are responsible, Defendants argue that the Receiver should have ignored Wellspring transactions involving e-gold or e-bullion because those transactions supposedly did not involve “a transfer of funds that were deposited into a bank account controlled by Prater and/or Wellspring located in the United States,” as required by the definition of Eligible Claimant in § A.2 of the Distribution Plan. The Court is not persuaded.

As the Receiver correctly explains in his response to Defendants’ motion, e-bullion and e-gold are legitimate electronic currency transfer systems that allow customers to pay for goods and services electronically via the Internet. *See Receiver’s Response II* [doc. # 147] at 2. Customers do so by providing real funds to an e-bullion or e-gold service, which creates an account for the customer in the amount of the funds provided and then invests the customer’s funds in gold held for the benefit of all customers. E-bullion account holdings represent a claim to a specified quantity of gold. If a customer then wishes to purchase something from an Internet seller for, say, \$100, the e-bullion service debits the customer’s e-bullion account and transfers \$100 of worth of gold to the account of the seller, which can then convert the gold into currency.<sup>2</sup> According to the e-bullion and e-gold services, they allow digital currency transactions to be backed by the physical commodity of gold, rather than by debt or other financial instrument,

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<sup>2</sup> These legitimate e-gold services should be contrasted with SpringPay, an account created and used by Prater as a part of his fraudulent pyramid scheme. *See Receiver’s Response II* [doc. # 147] at 3. The non-cash credits in SpringPay accounts were not real but were a device used to mask Defendants’ pyramid scheme, and therefore, the Receiver properly excluded credits to SpringPay accounts to the extent they did not involve the transfer of real funds. According to the Receiver, the SEC and FBI have found no evidence that SpringPay was used by any non-Wellspring participant. *Id.* at 7.

thereby reducing financial or currency risk. *See, e.g.*, <http://www.e-gold.com>; <http://www.e-bullion.com> (last visited August 23, 2005).

Some investors in Wellspring used e-bullion or e-gold services to make their investments in Wellspring. According to the Receiver, who has examined Wellspring's banking and other records, when an investor used the e-bullion or e-gold services, Wellspring's account would be credited with an interest in gold equal to the value of the amount invested and Wellspring would regularly convert the gold in its accounts to cash, which Wellspring then deposited in its bank accounts. *See* Receiver's Response II [doc. 147] at 2. In those circumstances, the investor had, in fact, transferred real funds to Wellspring that were ultimately deposited into a U.S. bank account controlled by Prater and/or Wellspring, thus satisfying the definition of Eligible Claimant in the Distribution Plan. As the Receiver correctly concluded, there is no valid justification for excluding or disadvantaging those investors who chose to use legitimate e-currency services to make their investments in Wellspring. Defendants' assertions to the contrary are either without record support or are flat wrong.

Accordingly, the Court will not set aside the Receiver's determinations as contrary to the Distribution Plan. The Receiver should forthwith make distributions to investors from the Escrow Fund in accordance with the Distribution Plan and his determinations of Eligible Claimants and Net Cash Losses.

## **B.**

By letter to John Kaiser attorney for Defendants, the Receiver sought a variety of information from Defendants relating to the Receiver's review of claims filed by individuals

residing in foreign countries. *See* Receiver's Second Request [doc. # 132] at 1. The information requested consists, among other things, of banking records of all foreign bank accounts maintained by Wellspring and/or Prater. Apparently, to date, the Receiver has not received the requested information from Defendants. Nor have Defendants objected to the Receiver's motion.

Under paragraph 14 of the Consent to Final Judgment of Permanent Injunction, Disgorgement and Other Relief [doc. # 88]:

Prater and Wellspring each agree to assist the receiver appointed in this action in the receiver's good faith efforts to identify the investors to whom the disgorgement amount should be distributed and to determine the amount of each investor's net investment loss.

*See also* Receiver Order ¶ 2(g) ("defendant Prater and all officers, agents, servants, employees attorneys-in-fact and shareholders of Wellspring shall cooperate with and assist the Receiver").

Accordingly, **by no later than September 10, 2005**, Defendants shall provide all information in their possession, custody or control that refers to or relates to each category of information requested by the Receiver, as set forth in the Receiver's Second Request. **Defendants are hereby cautioned that a failure to comply with the Receiver's Second Request may result in the imposition of sanctions.**

### C.

In its Ruling and Order dated April 21, 2005 [doc. #121], the Court directed the Receiver to commence a quiet title action regarding the Prater residence in an effort to augment the Escrow Fund. However, the Court first required the Receiver to submit a proposed budget estimating the anticipated costs of that effort. The Receiver first sought to settle his claim to the Prater residence amicably so as to avoid litigation costs and delays, but the Receiver reports that

he was unable to reach a reasonable settlement with Prater. *See* Memorandum of Receiver Regarding Defendant Prater's Homestead [doc. # 113] at 2; Receiver's Proposed Budget Estimating Costs of Quiet Title [doc. # 133] at 2. Therefore, the Receiver has proposed a budget for the quiet title action that estimates the costs as between \$11,700-13,500 (exclusive of trial time), though the Receiver rightly cautions that the ultimate costs will be affected by the degree to which Defendants cooperate with the Receiver in the litigation.<sup>3</sup> *Id.*

The Receiver's estimate of costs appears to be reasonable, and the Court hereby APPROVES it. The Receiver should promptly commence the quiet title action and should provide monthly billings against the estimate so that the costs incurred in pursuing this action can be monitored.

#### **D.**

Both of the attorneys who have filed appearances on behalf of Defendants have moved to withdraw their appearances on the ground that disputes have arisen between counsel and Defendants, and Prater has now decided to proceed *pro se*. *See* Motion by John Kaiser to Withdraw as Attorney for Defendants [doc. # 136]; Motion by Kit Barron Bradshaw to Withdraw as Attorney for Defendants [doc. # 144]; Pro Se Appearance [doc. # 138]; Prater Letter Acknowledging Attorney Kaiser's Withdrawal [doc. # 149].

It appears that good cause exists for the withdrawal of the appearances on behalf of Prater personally and therefore to that extent the motions are granted. However, counsel also appear to

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<sup>3</sup> According to the Receiver, Prater purchased the residence in May 2003 for \$283,500 and the residence is currently thought to be worth in excess of \$300,000. *See* Ruling and Order dated April 21, 2005 [doc. # 121] at 3; Receiver's Second Report [doc. # 125] at 1.

wish to withdraw their appearances on behalf of Wellspring, a corporation. A corporation cannot appear *pro se*, as this Court has previously advised Prater on several occasions. *See, e.g., Prater*, 289 F. Supp. 2d 39, at 43. Therefore, if the Court permits counsel to withdraw their appearances on behalf of Wellspring, the corporation will be unrepresented in this action. While this case is in the post-judgment stage, it is apparent from the foregoing that issues remain regarding final implementation of the parties' settlement. Moreover, the Receiver still needs Wellspring's cooperation to provide information needed to complete the settlement. As a consequence, the Court is not yet willing to allow counsel to withdraw their appearances on behalf of Wellspring. However, the Court will permit counsel to renew their motion as to Wellspring, if they choose, so long as they provide the Court with a statement of how Wellspring's interests as well as the Receiver's will be protected in the absence of an appearing counsel for the corporate defendant.

Accordingly, the Court GRANTS IN PART and DENIES IN PART the Motions to Withdraw [doc. # # 136, 144].

### III.

To summarize, the Court: DENIES Defendants' Motion to Set Aside the Receiver's Determination of Eligible Claimants and Net Cash Losses [doc. # 123]; GRANTS the Receiver's Second Request that the Court Require Defendant Prater to Provide Requested Information [doc. # 132]; APPROVES the Receiver's Proposed Budget for Quiet Title Action [doc. # 133] regarding Prater's residence; GRANTS IN PART and DENIES IN PART Motion by John Kaiser to Withdraw as Attorney for Defendants [doc. # 136]; and GRANTS IN PART and DENIES IN PART Motion by Kit Barron Bradshaw to Withdraw as Attorney for Defendants [doc. # 144].

In concluding, the Court acknowledges that the process of providing repayments to those who were defrauded by Defendants' scheme has taken longer than the Court had hoped when it entered its preliminary injunction order. However, as the chronology set forth above and in the Court's prior decisions should make clear, so far as the Court has been able to discern, Defendants (and not the SEC or the Receiver) have been the principal cause of this delay. Defendants first delayed entering into a final settlement with the SEC, then delayed producing needed records and information to the SEC and the Receiver. Defendants have now filed unmeritorious objections to the Receiver's determinations of losses in an apparent effort to reduce the amount paid to investors, and have opposed the Receiver's efforts to augment the funds available to investors through sale of the Prater residence. It is the Court's fervent hope that with the last remaining objections resolved, funds can now start flowing to the investors and that they will finally begin to receive at least some recompense for their losses.

IT IS SO ORDERED,

/s/ Mark R. Kravitz  
United States District Judge

Dated at New Haven, Connecticut: **August 24, 2005**