

REQUEST FOR ARBITRATION AND STATEMENT OF CLAIM

UNDER THE UNCITRAL ARBITRATION RULES

AND SECTION B OF CHAPTER 10 OF THE

DOMINICAN REPUBLIC - CENTRAL AMERICA - UNITED STATES

FREE TRADE AGREEMENT

**COSTA RICAN AND
DOMINICAN VICTIMS OF THE
STANFORD PONZI SCHEME**

INVESTORS / CLAIMANTS

and

THE GOVERNMENT OF THE UNITED STATES OF AMERICA

PARTY / RESPONDENT

Pursuant to Article 10.16(1)(a) of the Dominican Republic - Central America - United States Free Trade Agreement ("CAFTA"), the Claimants hereby serve this Request for Arbitration and Statement of Claim for the non-compliance of the Government of the United States of America (the "U.S.A.," the "United States" or the "Respondent") with certain of its obligations under the CAFTA.

I. NAME AND ADDRESS OF THE DISPUTING INVESTORS

1. Pursuant to powers of attorney granted by each claimant to his, her or its attorney, the addresses for the Claimants/Investors are as follows:

c/o:

Mr. Edward F. Valdespino
Strasburger & Price, LLP
300 Convent Street, Suite 900
San Antonio, Texas
78205

II. BREACH OF OBLIGATIONS

2. The Claimants allege that the United States has acted inconsistently with its obligations under Section A of Chapter 10 of the CAFTA, with respect to the following provisions:
 - i) Article 10.3 – National Treatment;
 - ii) Article 10.4 – Most-Favored-Nation Treatment; and
 - iii) Article 10.5 – Minimum Standard of Treatment.
3. In relevant part, the text of each applicable CAFTA provision is as follows:

Article 10.3. National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.
2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Article 10.4. Most-Favored-Nation Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.
2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of investors of any other Party or of any non-Party with respect

to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Article 10.5. Minimum Standard of Treatment¹

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.
2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:
 - (a) “fair and equitable treatment” includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
 - (b) “full protection and security” requires each Party to provide the level of police protection required under customary international law.

Note 1: Article 10.5 shall be interpreted in accordance with Annex 10-B.

Annex 10-B Customary International Law

The Parties confirm their shared understanding that “customary international law” generally and as specifically referenced in Articles 10.5, 10.6, and Annex 10-C results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 10.5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.

III. FACTUAL BASIS FOR THE CLAIM

4. The Claimants allege that the Respondent failed to provide even a rudimentary level of protection or legal security to them as CAFTA investors in the Houston, Texas-based Stanford Financial group of companies, which directly led the Claimants to lose their investments as the victims of a massive U.S.-based Ponzi scheme. The decision taken by U.S. regulatory officials to “do nothing” after identifying the fraudulent nature of the Stanford enterprise violated the legitimate expectations of these investors and discriminated against them on the basis of their foreign nationality.

The Investors and their Investments in the Territory of the United States

5. The Claimants are all either nationals of the Republic of Costa Rica or the Dominican Republic. They made investments, directly and/or indirectly, in and through the Stanford Financial Group of companies in the United States, primarily in (what were later revealed to be) fraudulent certificates of deposit issued by Stanford International Bank (“SIB CDs”), an Antiguan-based instrumentality of the Stanford Financial Group of companies (“SFG”) which was managed and controlled, and had its principal base and center of main interest, in the United States.
6. SFG was established and operated by Allen Stanford - and others - for the purpose of defrauding investors, primarily foreign nationals from Latin America, including the Claimants. As the fraud expanded, the targets of SFG’s scheme expanded to include U.S. and foreign nationals from other parts of the world. The scheme involved SFG’s principals (primarily Allen Stanford) directing a portion of the funds invested to pay returns to earlier investors, while absconding with the remainder. In short, it was a classic “Ponzi scheme.”
7. SFG’s principals induced Latin American foreign investors, including the Claimants, to invest with SFG by touting SFG as a U.S. operation with FINRA registration, SIPC insurance coverage, and protected by the celebrated credibility of the U.S. financial regulatory system.¹ As part of the sales pitch they received, the Claimants were repeatedly assured that they were investing with broker-dealers licensed (and therefore regulated) by the United States Securities and Exchange Commission (“SEC”).

A Shocking and Egregious Story of Systemic Regulatory Failure

8. The Respondent has reaped the benefits of inbound foreign investment for many decades, thanks in no small part to the stellar reputation of its financial regulatory regime. The high esteem in which United States financial regulators were held seemed well deserved to the Claimants, abetted as it was by regular updates from the SEC itself, which still promotes its enforcement victories on its web site. It was not until the financial crisis of 2008-2009 that the truth began to emerge. Since that time, report after report revealed deep fissures running through the façade of strength and reliability long portrayed about U.S. financial markets, and about the government officials who police them.
9. Referring to itself as "the Investor's Advocate," the SEC publicly confirms that its "primary mission [is] to protect investors and maintain the integrity of the securities markets" and that its "enforcement authority" is "critical to the SEC's effectiveness." Exchange Commission (SEC) is to protect investors and maintain the integrity of the securities markets. As more and more first-time investors turn to the markets to help secure their futures, pay for homes, and send children to college, these goals are more compelling than ever. On a web page entitled "How the SEC Protects Investors and Maintains Market Integrity," it has explained:

[The Securities Act of 1933 and the Securities Exchange Act of 1934] were designed to restore investor confidence in our capital markets [following the 1929 stock market

¹ FINRA is the United States Financial Industry Regulatory Authority. SIPC is the United States Securities Investor Protection Corporation.

crash] by providing more structure and government oversight. The main purposes of these laws can be reduced to two common-sense notions:

- Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing.
- People who sell and trade securities – brokers, dealers, and exchanges – must treat investors fairly and honestly, putting investors' interests first.

Monitoring the securities industry requires a highly coordinated effort. Congress established the Securities and Exchange Commission in 1934 to enforce the newly-passed securities laws, to promote stability in the markets and, most importantly, to protect investors.²

10. Up until 2005, the SEC's web site still touted the agency's record of bringing between 400 and 500 civil enforcement actions annually, serving to protect individuals who invested with U.S. broker/dealers licensed by the SEC. The Claimants were entitled to expect that – as soon as Examination staff from the SEC's Fort Worth Office uncovered the Stanford Ponzi scheme – theirs would have been among the interests protected by the SEC.
11. It was as early as 1997 that the Examination Division of the SEC's Fort Worth District Office began investigating SFG. Examination Division officials commenced what would sadly become only the first of many investigations into the structure, financing and operations of SGC – through their examination of SFG's registered broker/dealer and investment adviser company, Stanford Group Company ("SGC"). Staff from the SEC's Examination Division concluded that it was probable that SFG, by and through its constituent companies (including SIB) was operating a Ponzi scheme. The SEC Examination staff accordingly referred these findings to their colleagues in the Fort Worth District Office's Enforcement Division for follow-up.
12. In 1998, Enforcement staff quickly opened and closed a cursory investigation of SGC. Examination staff accordingly undertook a second examination of SGC investment adviser operations in 1998, concluding once again that it was probable that SFG's sales of SIB CDs to Latin American foreign investors, including the Claimants, were fraudulent. Nevertheless, staff from the Enforcement Division decided once again not to follow up with any further investigation of SGC/SFG.
13. Regulators took no further interest in SGC until 2002, when the Examination staff conducted a third examination of SGC's investment adviser operations and referred the file to the SEC's Enforcement staff in December 2002, on the grounds that SGC was violating the *Investment Advisers Act*, 15 U.S.C. § 80b-1-21, because SGC advisers and brokers were clearly failing to perform necessary due diligence before selling SIB CDs to investors, including some of the Claimants.

² See, e.g: the following U.S. SEC web site page archived for December 1999, at URL: <<http://web.archive.org/web/20011002001944/http://www.sec.gov/about/whatwedo.shtml>>, accessed: 25 November 2012.

14. In December 2002, the SEC received a letter from a Mexican citizen concerned about her elderly mother's investments in SFG and describing how SFG brokers/advisers had assured her mother (and other investors) that the SIB CDs were backed by private insurance from Lloyd's. The SEC, acting under the directions of Spencer Barasch, once again took no action with respect to that letter. Barasch told his colleagues that he referred the matter to the Texas State Securities Board ("TSSB"), although the TSSB has no record of any such referral. Every SEC witness questioned about this incident expressed incredulity that Barasch would have made such a referral to the TSSB.
15. The SEC's Enforcement staff did not review the 2002 Examination Report prepared by Examination staff and they did not open an inquiry into SGC/SFG.
16. Enforcement staff received two outside complaints in 2003, which raised allegations that SFG was engaged in the conduct of a Ponzi scheme. They did nothing to pursue either complaint.
17. Agencies of the U.S. Government were also aware of further wrongdoing by Stanford in this same time period, including over \$250 million in transfers – via unsecured related party loans - from SIB to Stanford and SFG that the IRS noted to Stanford's external accountant had not been disclosed in SIB's annual report or in its audited financial statements, as well as the fact that, while Stanford reported to the IRS that he had made \$2.95 million in interest payments to SIB, its annual report evidenced a payment of only \$480,000.
18. In October 2004, Examination staff conducted a fourth examination of SGC and concluded, for a fourth time, that SGC/SFG's marketing and sale of SIB CDs was part of a Ponzi scheme, conducted from SFG's Houston headquarters.
19. Thereafter, from October 2004 to March 2005 Examination staff conducted significant further investigative work, documenting an inevitable new enforcement referral. Upon learning of the ongoing work of Examination staff, in March 2005 Enforcement staff informed Examination staff that they were not prepared to pursue any enforcement against SGC/SFG.
20. In April 2005, the Examination staff nonetheless referred the SGC matter to Enforcement staff for follow up. No action was taken against SGC as a result. By November 2005, Examination staff asked their colleagues in Enforcement to file an emergency action against SIB, in order to end what was now a mammoth Ponzi scheme. Still, no action was taken.
21. It would not be until October 26, 2006, after a period of intense infighting amongst Enforcement staff members, that a formal order of investigation was obtained with respect to SGC. Unbelievably, sixteen months later Enforcement staff decided to end their perfunctory investigatory activities into SGC and referred the matter to the United States Department of Justice. Any further SEC investigation of SGC by Fort Worth Office Enforcement staff, came to a grinding halt with this decision.

22. Eight months later, in December 2008, the Madoff Ponzi scheme came to light. As a result, the SEC's Dallas Enforcement staff decided to revisit the SGC file. On February 17, 2009 the SEC finally filed an action against SGC, although even by this late date Enforcement staff initially declined to allege that SGC had actually been operating a Ponzi scheme for over a decade.
23. Had the SEC taken reasonable steps to subject SGC to a modicum of appropriate regulatory oversight in the twelve (12) years prior to February 17, 2009, significant losses suffered by all of the Claimants could have been avoided.
24. The U.S. Senate Banking Committee would subsequently conduct an investigation into the SEC's conduct in connection to the prolongation of the SFG Ponzi scheme. In answering questions posed to her by Committee Members during an oral hearing held in New Orleans, a senior member of the Enforcement Division from the Fort Worth District Office actually admitted that Enforcement staff had been disinterested in pursuing regulatory action against SGC any sooner because most of the victims appeared to be foreign (i.e. Latin American) investors in the United States, rather than citizens of the United States.
25. As it turns out, the SEC was not the only one of the Respondent's financial enforcement agencies that could have stopped Stanford years earlier, thereby saving thousands of his then- and future-victims from experiencing serious financial loss. By the end of 2003 – not long after SEC Examination staff had conducted their third investigation of SGC, to no avail by – agents of the U.S. Internal Revenue Service ("IRS") were communicating directly to Harry Failing, Stanford's personal accountant, about certain manifest discrepancies contained within his 1999 tax return, which they had apparently been examining for at least two years.
26. Indeed, by the end of 2003 IRS agents had already identified a number of serious irregularities with respect to the business dealings between Stanford, SIB and the SFG, any of which could have, and should have, triggered a referral to federal prosecutors for criminal fraud. Instead, by the time that SEC Enforcement Staff finally took action against SGC, they discovered that IRS officials were still busily engaged in negotiations with Stanford employees over how much he owed the Respondent, in personal income taxes, as a result of the manifestly fraudulent financial activities in which they knew he had been engaged for at least a decade.
27. Examples of Stanford and SFG improprieties, which were known to the IRS by the end of 2004, included the aforementioned failure of SIB to disclose over \$250 million in unsecured loans it had made to SFG and Stanford in its 1999 Annual Report, as well as the evident discrepancy between the amount of interest Stanford claimed he had paid to SIB in 1999, as between his personal tax return and SIB's 1999 annual report. IRS officials had similarly observed that the over \$250 million in unsecured related party loans to Stanford and SFG were also absent from SIB's audited financial statements. They would subsequently direct Stanford to pay \$20.8 million in additional taxes and penalties, in 2000, and \$53.4 million in additional taxes and penalties in 2001, for the still-outstanding and unaccounted-for loans.

28. At the end of 2004, IRS officials had concluded that SFG itself had borrowed \$205 million from SIB in 2002, without having repaid any principal or interest. Nearly five years before the Ponzi scheme ended, IRS officials had actually noted how SFG's related company affiliates could not have survived without the funds being loaned to them by SFG, which had in turn borrowed them from SIB. IRS agents had also noted that no interest or principal had been paid on these loans either. All of the SFG related party companies had been reporting losses and negative retained earnings at the time.
29. At this same time, IRS officials had further observed that, separate and apart from the aforementioned line of credit from SIB, extended to Stanford and SFG in 1999, SFG had also borrowed an additional \$19M from SIB in 1999, which had allegedly been used to fund investments in private equity companies. IRS officials had therefore concluded that the only reason SIB continued to advance funds to SFG – without receiving any repayment or even any collateral in return – was because both were under Stanford's control. IRS officials knew that SFG did not possess the means to repay these outstanding loans from SIB, and that SFG was, in fact, totally dependent upon SIB fees for survival.
30. Also in December 2004, IRS officials were aware that SIB's 2001 audited financials did not disclose the outstanding loans it had made Stanford, SFG or to any related party entities and that, they were being lied to by Stanford's accountant, Failing. They also knew that, by 2004, Stanford had personally already borrowed at least \$114 million from SIB, none of which had been disclosed in its 2001 Annual Report. Rather than criminally investigating what was manifestly a Stanford-orchestrated financial fraud of already staggering proportions, IRS officials merely elected to deem the unreported loans as constructive dividends, as part of a "proposed adjustment" for the tax years 2000 and 2001, for which Stanford had incredulously reported no taxable income.
31. Thus, by 2005 the IRS knew that SIB had made no less than \$319 million in unsecured loans to Stanford and SFG, which represented a substantial proportion of the entirety of SIB's purported investment portfolio at the time. IRS agents had surmised that 2/3 of those loans had gone to SFG, which allowed it to maintain the [false] appearance of viability for a number of outposts within Stanford's Potemkin empire. Nonetheless, throughout this period it appears that the IRS was only interested in compelling Stanford to pay additional taxes, rather than referring his case to federal prosecution for fraud.
32. As a direct result of the Respondent's manifest failure to end the Stanford Ponzi scheme over a span of a dozen years from the date its own officials identified the scheme to the date they took meaningful enforcement action, the Claimants lost investments worth hundreds of millions of dollars. Attached at Appendix I are estimates of the individual losses suffered by each Claimant.

The Aftermath

33. The Respondent effectively admitted responsibility for the SEC's failure to stop the Stanford Ponzi scheme, over a span of nearly twelve years, during the month of April 2010. It did so in a scathing report conducted by the SEC's own Office of the Inspector

General, a copy of which is attached at Appendix II. The Report, which was submitted to the SEC by then Inspector General H. David Kotz on 31 March 2010, also contains confirmation of the discriminatory animus that had led SEC Enforcement Division staff in the Fort Worth Office to turn a blind eye to the Ponzi scheme – on the basis that the primary targets of fraud were foreign (i.e. primarily Latin American) investors.

34. The Report provides a detailed, chronological account of the SEC's failure to prevent the Stanford Ponzi scheme from growing into the behemoth it would become, in addition to references to an abundance of evidence gathered, but not released with, the report. The following are some pertinent excerpts from the Report's executive summary, in addition to the recommendations found in its conclusion:

The OIG investigation found that the SEC's Fort Worth office was aware since 1997 that Robert Allen Stanford was likely operating a Ponzi scheme, having come to that conclusion a mere two years after Stanford Group Company ("SGC"), Stanford's investment adviser, registered with the SEC in 1995. We found that over the next 8 years, the SEC's Fort Worth Examination group conducted four examinations of Stanford's operations, finding in each examination that the CDs could not have been "legitimate," and that it was "highly unlikely" that the returns Stanford claimed to generate could have been achieved with the purported conservative investment approach. Fort Worth examiners dutifully conducted examinations of Stanford in 1997, 1998, 2002 and 2004, concluding in each case that Stanford's CDs were likely a Ponzi scheme or a similar fraudulent scheme. The only significant difference in the Examination group's findings over the years was that the potential fraud grew exponentially, from \$250 million to \$1.5 billion.

While the Fort Worth Examination group made multiple efforts after each examination to convince the Fort Worth Enforcement program ("Enforcement") to open and conduct an investigation of Stanford, no meaningful effort was made by Enforcement to investigate the potential fraud or to bring an action to attempt to stop it until late 2005. In 1998, Enforcement opened a brief inquiry, but then closed it after only 3 months, when Stanford failed to produce documents evidencing the fraud in response to a voluntary document request from the SEC. In 2002, no investigation was opened even after the examiners specifically identified multiple violations of securities laws by Stanford in an examination report. In 2003, after receiving three separate complaint letters about Stanford's operations, Enforcement decided not to open an investigation or even an inquiry, and did not follow up to obtain more information about the complaints.

In late 2005, after a change in leadership in Enforcement and in response to the continuing pleas by the Fort Worth Examination group, who had been watching the potential fraud grow in examination after examination, Enforcement finally agreed to seek a formal order from the Commission to investigate Stanford. However, even at that time, Enforcement missed an opportunity to bring an action against SGC for its admitted failure to conduct any due diligence regarding Stanford's investment portfolio, which could have potentially completely stopped the sales of the Stanford International Bank ("SIB") CDs through the SGC investment adviser, and provided investors and

prospective investors notice that the SEC considered SGC's sales of the CDs to be fraudulent. The OIG investigation found that this particular action was not considered, partially because the new head of Enforcement in Fort Worth was not apprised of the findings in the investment advisers' examinations in 1998 and 2002, or even that SGC had registered as an investment adviser, a fact she learned for the first time in the course of this OIG investigation in January 2010.

The OIG did not find that the reluctance on the part of the SEC's Fort Worth Enforcement group to investigate Stanford was related to any improper professional, social or financial relationship on the part of any former or current SEC employee. We found evidence, however, that SEC-wide institutional influence within Enforcement did factor into its repeated decisions not to undertake a full and thorough investigation of Stanford, notwithstanding staff awareness that the potential fraud was growing. We found that senior Fort Worth officials perceived that they were being judged on the numbers of cases they brought, so-called "stats," and communicated to the Enforcement staff that novel or complex cases were disfavored. As a result, cases like Stanford, which were not considered "quick-hit" or "slam-dunk" cases, were not encouraged.³

...

Had the SEC successfully prosecuted an injunctive action against SGC for violations of Section 206, an anti-fraud provision, it could have completely stopped the sales of the SIB CDs through the SGC investment adviser. Further, the filing of such an action against SGC could have potentially given investors and prospective investors notice that the SEC considered SGC's sales of the CDs to be fraudulent. A Stanford Victims Coalition survey indicated that approximately 95% of 211 responding Stanford investors stated that knowledge of an SEC inquiry would have affected their decision to invest. One Stanford victim, who invested the money that she "saved through several years of business, nights working late and skipping vacations [she] could have taken with [her] family," said that had she "known that Stanford Group was ever under investigation by the SEC, [she] would not have bought at all." Indeed, the questionnaire that was sent out by Enforcement in June 2005 raised significant concerns among Stanford investors. A former vice president and financial adviser at Stanford from 2004 through 2007 who later contacted the SEC with concerns about Stanford, said that his phone "lit up like a Christmas tree the morning [the SEC questionnaire] went out." However, after investors received the questionnaire about Stanford, many continued to invest because financial advisers told them that the fund had been given "a clean bill of health" by the SEC. Stanford officials were able to persuasively represent that Stanford had been given this "clean bill of health" because in fact, Stanford had been examined on multiple occasions and only been issued routine deficiency letters which they purportedly remedied. However, had a Section 206 action

³ United States Securities and Exchange Commission, Office of the Inspector General, *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme*, Case No. OIG-526, 31 March 2010, at 16-17.

been commenced in 2005, it could have put many of Stanford's victims on notice that there were regulatory concerns about their investments.⁴

...

The OIG's findings during this investigation raise significant concerns about how decisions were made within the SEC's Division of Enforcement with regard to the Stanford matter. We are providing this Report of Investigation ("ROI") to the Chairman of the SEC with the recommendation that the Chairman carefully review its findings and share with Enforcement management the portions of this ROI that relate to the performance failures by those employees who still work at the SEC, so that appropriate action (which may include performance-based action, if applicable) is taken, on an employee-by-employee basis, to ensure that future decisions about when to open an investigation and when to recommend that the Commission take action are made in a more appropriate manner.

The OIG is also recommending that the Chairman and the Director of Enforcement give consideration to promulgating and/or clarifying procedures with regard to:

- (1) the consideration of the potential harm to investors if no action is taken as a factor when deciding whether to bring an enforcement action, including consideration of whether this factor, in certain situations, outweighs other factors such as litigation risk;
- (2) the significance of bringing cases that are difficult, but important to the protection of investors, in evaluating the performance of an Enforcement staff member or a regional office;
- (3) the significance of the presence or absence of United States investors in determining whether to open an investigation or bring an enforcement action that otherwise meets jurisdictional requirements;
- (4) coordination between the Enforcement and OCIE on investigations, particularly those investigations initiated by a referral to the Enforcement by OCIE;
- (5) the factors determining when referral of a matter to state securities regulators, in lieu of an SEC investigation, is appropriate;
- (6) training of Enforcement staff to strengthen their understanding of the laws governing broker-dealers and investment advisers; and
- (7) emphasizing the need to coordinate with the Office of International Affairs and the Division of Risk, Strategy, and Financial Innovation, as appropriate, early in the course of investigations in which relevant documents, individuals, or entities are located abroad.⁵

35. On or about 15 June 2011, the Respondent stated its position that, as a matter of applicable municipal law, "depositing money with SIBL was, for SGC accountholders, in reality no different than depositing it with SGC", the U.S.-based broker-dealer.⁶ This

⁴ *Ibid*, at 24-25.

⁵ *Ibid*, at 150-151.

⁶ United States Securities and Exchange Commission, *Analysis of Securities Investor Protection Act Coverage for Stanford Group Company* (undated). See URL: <<http://www.sec.gov/rules/other/2011/stanford-sipa-analysis.pdf>>, accessed 28 March 2013, at 9.

statement was included in an official document issued by the SEC entitled: *Analysis of Securities Investor Protection Act Coverage for Stanford Group Company*, a copy of which is attached at Appendix III. In it, the Respondent cited, with approval, the observation of the Receiver, who had been appointed by a U.S. Federal Court to oversee the dissolution of SFG, and the distribution of any remaining assets to victims, that no distinction could validly be made amongst any SFG entities, "since all of the Stanford entities, SIB included, were part of the same Ponzi scheme, puppets of the same puppeteer."⁷ The Respondent further observed:

Additionally, as in *Old Naples*, there are facts that could have led SGC account holders who purchased SIBL CDs through SGC to believe they were depositing cash with SGC for the purpose of purchasing the CDs. Defrauded CD investors have submitted affidavits stating that they were told by their SGC financial advisors that SGC and SIBL were both members of the "Stanford Financial Group," and that Stanford financial advisers frequently referred simply to "Stanford" without clearly distinguishing between SGC and SIBL. Both SGC and SIBL had the word "Stanford" in their names and used the same logo, and SGC provided at least some customers with "advisory statements" bearing that logo that listed their SIBL CD positions. Purchasers also paid for the CDs in accordance with SGC's payment instructions. As the Receiver found, "[m]ost CD purchasers never saw [a] SIB[L] employee, and instead dealt only with their financial advisor, who, to them, was the face of the Stanford companies, including SIB[L]." One indication of investor confusion regarding the entity with which they were depositing money to purchase the SIBL CDs is that at least some customers made checks for the purchase of the CDs payable to "Stanford."⁸

36. On or about 30 July 2012, a U.S. Federal Court came to the same conclusions about the nature and structure of the Stanford Ponzi scheme, as indicated in its Order, attached as Appendix IV. In addition, the Court made the following findings of fact, which have since been vouchsafed by counsel for the Respondent in various other U.S. and international proceedings:

As explained in more detail above, R. Allen Stanford, a dual U.S. and Antiguan citizen, was the sole owner, directly or indirectly, of the more than 130 Stanford Entities. He controlled the Stanford Entities with substantial assistance from Davis and Pendergest-Holt, both U.S. citizens. Stanford lived and worked principally in Houston; Texas; Miami, Florida; and Christiansted, St. Croix, U.S.V.I. Davis and Pendergest-Holt lived in Mississippi and had offices in Houston, Texas; Tupelo, Mississippi; and Memphis, Tennessee. The Stanford Entities' headquarters was in Houston, Texas. Stanford never lived in Antigua, and Antigua did not serve as the base of the Stanford Entities' operations.

Most of the Stanford Entities' revenue came from selling CDs. CD sales largely bypassed Antigua, as depositors wishing to deposit funds were usually introduced to SIB through their financial advisors, who maintained primary if

⁷ *Ibid*, at 9.

⁸ *Ibid*, at 9-10.

not sole contact with the depositor and were often located where the depositor resided. U.S. investors exclusively purchased CDs through broker-dealers in the United States at SGC. All financial advisors, regardless of location, would send client applications and requisite paperwork to Antigua, and SIB would then deposit the funds into U.S., Canadian, and English banks. Investors wired money to Canadian banks or English banks. Those who wished to pay via check provided checks to their financial advisors at a non- Antiguan location. Financial advisors would send the checks to SIB in Antigua, and, after endorsing them, SIB would send the checks to Houston, Texas for deposit in Canada or the United Kingdom. After deposit, Davis would then disburse the funds among the Stanford Entities.⁹

...

Stanford employees managed and directed the CD enterprise from the United States with no meaningful input from Antigua. Although SIB, the issuing bank, was chartered and registered in Antigua, Stanford and Davis controlled it – with assistance from Pendergest-Holt – from various places within the United States. And Davis facilitated several millions of dollars in transfers of CD proceeds among the Stanford Entities. Antiguan employees were excluded from decisions regarding SIB’s self-professed primary business: CD-proceed investments. Other Stanford Entities managed and directed the investment accounts, and, although those entities sent bank statements to SIB in Antigua, personnel from other Stanford Entities reviewed and processed them. Only Stanford, Davis, and Pendergest-Holt were primarily responsible for investments and investment accounting.

Stanford and his associates in the United States generated and maintained SIB’s financial information. Stanford, Davis, Pendergest-Holt, and other U.S. residents disseminated false information regarding SIB’s financial strength, profitability, capitalization, investment strategy, investment allocation, value of its investment portfolio, and other matters to financial advisors around the world for use in inducing potential investors to purchase CDs. Indeed, Davis managed the Stanford Entities Tier 1 assets – cash and cash equivalents – via the Treasury Department in Houston, Texas. SIB invested its Tier 2 assets – investments and a small amount of cash or cash equivalents – with outside money managers at banks in the United Kingdom and Switzerland. Pendergest-Holt and her team of research analysts in Memphis oversaw these investments. Finally, Stanford and Davis, with assistance from Pendergest-Holt and her team, managed Tier 3 assets – illiquid real estate, private equity investments, and undisclosed sham loans to Stanford. Davis provided the fallacious investment earning amounts for Tier 3 assets; Stanford and his U.S. employees, consulting with outside U.S. counsel, created the inflated \$3.174 billion real estate figure, representing a 50-fold baseless inflation of the properties; \$1.8 billion of Tier 3 assets were notes receivable from Stanford, representing sham loans to him that he funneled to Stanford Entities, 76% of which were outside Antigua; and finally, an inflated \$1.2 billion value was assigned to “merchant

⁹ *In Re: Stanford International Bank, Ltd.*, Order, Case No. 3:09-cv-00721-N (U.S. Dist. Ct. N.D. Tex., 30 July 2012) at 41-43.

banking” assets, consisting mostly of equity and debt investments in private and public companies, most of which were headquartered in the United States.

Additionally, extensive SIB client records exist in the United States, and records regarding SIB’s investments and cash balances were kept outside of Antigua, predominantly generated (i.e., fancifully created) and maintained in the United States by Stanford and Davis. Davis and other Houston-based Stanford employees – such as Harry Failing, Stanford’s longtime accountant in Houston – also generated false reports to disseminate to Stanford Entity investors and potential investors regarding SIB’s assets and liquidity. Stanford Entity employees in the United States wrote SIB’s purported internal audit reports. Although an Antiguan audit firm, C.A.S. Hewlett & Co. Ltd. also performed audits, the Receiver has shown that these were of minimal utility and veracity given that the firm did not review the records in the United States.

As for SIB, Stanford Entity employees in the United States fulfilled most of its core operational needs. This includes, but is not limited to, legal, training, investment, accounting, human resources, compliance, IT, and public relations services. All of SIB’s directors were non-Antiguans, and all but two were U.S. citizens. The Board met via tele- or video-conference or in person in Antigua, and once in Miami, Florida. Stanford Entity employees in the United States also received vastly more monetary compensation than employees in Antigua. Management, administrative, and marketing fees paid to Stanford Entities in the United States and the U.S.V.I. – \$268 million in 2008 – compared to total salary and benefits paid to SIB’s Antiguan employees – \$3.6 million in 2008 – illustrate this disparity. Indeed, the Joint Liquidators agree “that the amount of money that [SIB] was paying its employees was a tiny fraction of the millions and millions it was paying to these other Stanford [E]ntities.”

Stanford and his associates similarly managed and controlled other Stanford Entities from the United States. As discussed above, SFG and SGC were both U.S. companies, and at least approximately sixty-six other Stanford Entity companies were incorporated in the United States. STCL’s core function, trust administration of mostly SIB CDs, was conducted in the United States, even though its physical structure was in Antigua, its records were held in the United States, and its management and staff were paid from the United States. Of the remaining Stanford Entity companies not specifically incorporated in the United States, Stanford or a U.S. Stanford Entity owns 100% or nearly 100% of approximately forty-three of them; Stanford or a U.S. Stanford Entity owns 100% or nearly 100% of approximately twenty-eight more as a second-level parent; Stanford owns 100% of approximately eight more companies as a third-level parent; and finally, Stanford owns 100% or nearly 100% of the approximately three remaining companies as the ultimate parent.

Mixed evidence exists regarding third parties’ expectations. Although much of the depositor opening documentation refers to SIB’s domicile in Antigua and contains Antiguan law and jurisdiction clauses, and the marketing materials refer to SIB’s Antiguan headquarters, there is also evidence that many third parties were made to believe that the Stanford Entities were either U.S. enterprises, were U.S.-regulated, or had a substantial U.S. presence. For example, SIB held itself out to creditors, borrowers, other obligees, and the

U.S. Internal Revenue Service (“IRS”) as having locations in Memphis, Tennessee and Houston, Texas. SIB solicited or intended to solicit CD purchasers in all fifty U.S. states, and it made regulatory filings with state securities regulatory agencies in the United States. Even the Antiguan government stated that Stanford ran SIB from Houston, Texas – referring to Antigua as a mere transit point.

Most CD purchasers never saw or interacted with Antiguan employees, and notably, only a small number actually went to SIB’s Antiguan location to attempt to redeem their CDs (reporting that approximately 150 customers went to Antigua to demand return of their funds around the time SIB was shut down). Investors instead dealt only with their financial advisors, few of whom were based in Antigua. These financial advisors were essentially the face of the Stanford enterprise to investors, providing CD applications, CD investment managing, and Stanford brokerage accounts. The financial advisors disseminated reports prepared by Stanford, Davis, Pendergest-Holt, and others, which portrayed a global group of companies under the name SFG, headquartered in the United States. SIB’s marketing materials, in fact, advertised that it was able to pay higher interest, in part, because of “synergies” and cost-savings that resulted from it being part of SFG and because of a globally diversified investment strategy.¹⁰

37. Between 24 December 2012 and 31 December 2012, Latin Americans from no less than seven countries filed, with the Respondent, notices of intent to submit their claims to arbitration under a collection of investment protection treaties, including the instant one. The Claimants served notice, and have now requested arbitration with the Respondent, in order to obtain payment of the just compensation owed to them by the Government of the United States of America – because its officials could have prevented the Claimants from being deceived into investing in a colossal, fraudulent enterprise that it has consistently insisted was based in Houston, Texas – had those officials simply executed their professional responsibilities with due diligence, just as the Claimants were entitled to reasonably expect.

IV. LEGAL BASIS FOR THE CLAIM

38. SEC officials possessed both the authority and the responsibility to ensure that the Stanford Ponzi scheme was stopped as soon as it was discovered. SEC officials, who were responsible for protecting the investments of investors such as the Claimants against criminal enterprises such as SFG, acted with unconscionable negligence and/or manifest incompetence, causing millions of dollars of losses to the Claimants as a result.
39. This shocking and egregious failure to execute the Respondent’s duty to provide protection and security to foreign investors and their investments violates the customary international law minimum standard of treatment of aliens, which the Respondent has previously claimed to be represented in CAFTA Article 10.5 (under the full protection and security standard).

¹⁰ *Ibid*, at 44-50.

40. By repeatedly refusing to take reasonable steps to stop the Stanford Ponzi scheme uncovered by the SEC's Examination staff from the very same office, or even to take the simple step of notifying the public (and foreign investors) of these growing concerns, the Enforcement Division of the SEC's Fort Worth Office acted in a manner inconsistent with the customary international law minimum standard of treatment of aliens, which a North American Free Trade Commission statement, issued on July 21, 2001, states that the text of CAFTA Article 10.5 represents.
41. Such conduct is also manifestly inconsistent with autonomous standards of "fair and equitable treatment" and "full protection and security" – such as those found in Article II:3(a) of the 1994 U.S.A.-Ukraine BIT. The U.S.A. has promised investors from other CAFTA countries that it will accord treatment no less favorable to them than it has accorded to any other foreign investor, pursuant to CAFTA Article 10.4. This promise includes obligations undertaken in bilateral investment treaties between the U.S.A. and third countries, such as (but not limited to) the 1995 *Treaty Between the Government of the United States of America and the Government of Ukraine Concerning the Encouragement and Reciprocal Protection of Investment* (the "U.S.A.-Ukraine BIT"); the 1994 *Treaty between the U.S.A. and Jamaica Concerning the Reciprocal Encouragement and Protection of Investment* ("U.S.A.-Jamaica BIT"); and the *Treaty Between the Republic of Latvia Concerning the Encouragement and Reciprocal Protection of Investment* (the "U.S.A.-Latvia BIT").¹¹
42. Evidence taken under oath during Congressional investigations indicates that the Respondent's officials declined to take even the simplest of steps to stop the Stanford Ponzi scheme in 1997, or in subsequent years, on the basis of their belief that the majority of SFG's victims were not U.S. nationals. Yet the Respondent failed to provide any notice to the Claimants in spite of the SEC's concerns about SFG from 1997 through 2009.
43. Such decisions constituted both an "unreasonable" measure and a "discriminatory" measure, which impaired the Claimants' ability to sell or otherwise dispose of their investments in this fraudulent Ponzi scheme sooner, or would have prevented them from investing in it. Such conduct was contrary to Article II:2(b) of the 1994 U.S.A.-Jamaica BIT and Article II:3(b) of the 1994 U.S.A.-Ukraine BIT. These same decisions also constituted an "arbitrary" measure, contrary to Article II:3(b) of the 1995 U.S.A.-Latvia BIT.
44. The decisions taken by the Respondent, to allow the Stanford Ponzi scheme to continue and to flourish, were also inconsistent with the Respondent's obligation to accord treatment no less favorable to investors from other CAFTA countries than that which it was prepared to accord to U.S. investors. Such conduct was accordingly also inconsistent with the Respondent's obligations under CAFTA Article 10.3, because SEC officials

¹¹ At page II-US-9 of CAFTA Annex II, the U.S.A. has reserved the right to "adopt or maintain any measure that accords differential treatment to countries under an bilateral or multilateral international agreement in force or signed prior to the date of entry into force of [the CAFTA]." Treaty promises, provided in years past by the U.S.A. to other States – to refrain from acting in a manner inconsistent with certain, absolute legal standards in respect of the treatment of foreign investors and their investments – manifestly fall outside the scope of this reservation.

applied a nationality based litmus test, which blatantly favoured the interests of U.S. investors over those of foreign investors, in deciding whether to end a fraudulent Ponzi scheme taking place within United States territory.

V. ISSUES

45. Did the Respondent's omissions to act sooner against SFG/SGC constitute a breach of the customary international law minimum standard of treatment of aliens, which the Respondent admits must require full protection and security under CAFTA Article 10.5?
46. Did the Respondent's omissions to act sooner against SFG/SGC constitute a breach of the customary international law minimum standard of treatment of aliens, which the Respondent admits must require fair and equitable treatment under CAFTA Article 10.5?
47. Did the Respondent's omissions to act sooner against SFG/SGC constitute conduct inconsistent with CAFTA Article 10.4, because it was inconsistent with the autonomous versions of either the "fair and equitable treatment" standard or the "full protection and security" standard contained with various other BITs concluded by the United States?
48. Did the Respondent's decision not to act sooner against SFG/SGC, on the grounds that few U.S. nationals were originally being victimized, constitute a breach of CAFTA Article 10.3?
49. Did the Respondent's decision not to act sooner against SFG/SGC, on the grounds that few U.S. nationals were originally being victimized, constitute an arbitrary measure, a discriminatory measure, or an unreasonable measure, which impaired the establishment, use, enjoyment or disposition by the Claimants of their investments, contrary to various provisions of other BITs concluded by the United States, and therefore contrary to CAFTA Article 10.4?
50. Has the Respondent otherwise accorded better treatment to investors from third countries, or to its own investors, in respect of any of the means described above?

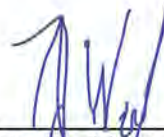
VI. RELIEF SOUGHT AND DAMAGES CLAIMED

51. The Claimants seek the following relief from an Arbitral Tribunal:
 - (a) A declaration that the Respondent has violated its obligations under CAFTA Article 10.5;
 - (b) A declaration that the Respondent has violated its obligations under CAFTA Article 10.3;
 - (c) A declaration that the Respondent has violated its obligations under CAFTA Article 10.4, by acting in a manner inconsistent with the provisions of other U.S. BITs, such as paragraphs (a) or (b) of Article II:3 of the 1994 U.S.A.-Ukraine BIT, or Article II:2(b) of the 1994 U.S.A.-Jamaica BIT;

- (d) An order that the Respondent immediately pay to the Investors damages of not less than US\$2,264,369.00, as compensation for the losses caused by, or arising out of, the U.S.A.'s conduct, found to be inconsistent with its obligations under Part A of CAFTA Chapter 10;
 - (e) All of the damages incurred in seeking compensation for the Respondent's conduct, including all of the costs incurred in proceeding with this arbitration, including all legal and other professional fees and disbursements;
 - (f) Pre-award interest at a rate compounded semi-annually;
 - (g) Post-award interest at a rate compounded semi-annually; and
 - (h) Such further relief as counsel may advise and that a tribunal may deem appropriate.
52. Pursuant to CAFTA Article 10.16:6, the Claimants hereby appoint Mr. David R. Haigh, Q.C., of Calgary, Canada, as one of the arbitrators who shall adjudge the parties' dispute, as per Article 10.19:1 of the CAFTA. Mr. Haigh's *curriculum vitae* is attached at Appendix V.

29 March 2013

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