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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

JOHN V. BIVONA; SADDLE RIVER ADVISORS, LLC; SRA MANAGEMENT LLC; FRANK GREGORY MAZZOLA,

Defendants, and

SRA I LLC; SRA II LLC; SRA III LLC; FELIX INVESTMENTS, LLC; MICHELE J. MAZZOLA; ANNE BIVONA; CLEAR SAILING GROUP IV LLC; CLEAR SAILING GROUP V LLC,

Relief Defendants.

Case No: 3:16-cv-01386-EMC

[PROPOSED] ORDER (1) DENYING THE RECEIVER'S AND THE SEC'S MOTION FOR APPROVAL OF A JOINT DISTRIBUTION PLAN AND (2) APPROVING THE ALTERNATIVE PLAN OF DISTRIBUTION PROPOSED BY THE SRA FUNDS INVESTOR GROUP

Date: September 28, 2017
Time: 1:30 PM
Courtroom: 5
Judge: Hon. Edward M. Chen

I. INTRODUCTION

On June 29, 2017, plaintiff Securities and Exchange Commission ("SEC") and the Receiver in the above-captioned matter, Sherwood Partners, Inc., filed with the Court their Motion for Approval of a Joint Distribution Plan. *See* ECF 196-200. Pursuant to the Court's June 6, 2017 Order Setting Schedule on Motion for Distribution Order (ECF 191), the SRA Funds Investor Group ("Investor Group") timely filed an objection to the Joint Distribution Plan, and proposed an Alternative Plan of Distribution for the Court's consideration and approval. *See* ECF 229. Another investor, Telesoft Capital, LLC ("Telesoft"), also timely filed an objection to the Joint Distribution Plan, and supports approval of the Investor Group's Alternative Plan of Distribution. *See* ECF 226.

According to its submission, the Investor Group consists of 134 individuals and entities who purchased and continue to hold membership interests in one or more of the seven SRA Funds at issue in the litigation.[1] The Investor Group collectively represents $40 million of the $53 million still invested in the SRA Funds and, in addition, Telesoft holds $1.5 million still invested. Together, the Investor Group and Telesoft represent 79% of the funds still invested and subject to any plan of distribution approved by the Court. As such, the Investor Group and Telesoft have a compelling and significant direct financial stake in the outcome of the pending litigation and any plan of distribution approved by the Court. There is no dispute that the Investor Group and Telesoft have legal standing to object to the Joint Distribution Plan.

Having read the Receiver's and the SEC's motion and the objections filed by the Investor Group and Telesoft, and having considered the arguments of the parties, the Investor Group and Telesoft, as well as the full record of this matter, and good cause appearing:

The Court HEREBY DENIES the Receiver's and the SEC's Motion for Approval of a Joint Distribution Plan, and ORDERS that the Alternative Plan of Distribution proposed by the Investor

[1] The seven funds are SRA I LLC, SRA II LLC, SRA II LLC, NYPA FUN I LLC, NYPA Fund II LLC, Felix Multi-Opportunity Fund I LLC, and Felix Multi-Opportunity Fund II LLC.

Group and supported by Telesoft be adopted and implemented as set forth in Part IV of this Order.

II. BACKGROUND

On March 22, 2016, the SEC filed this action against John V. Bivona, Frank Mazzola, the Corporate Defendants SRA Management Associates, LLC, and Relief Defendants SRA I LLC, SRA II LLC, SRA III LLC, Michele Mazzola, Anne Bivona, Clear Sailing Group IV LLC, and Clear Sailing Group V LLC. The SEC complaint (ECF 1) alleges multiple violations of the federal securities laws in connection with the sale of membership interests in and the management of the SRA Funds.

Concurrent with the filing of the complaint, the SEC moved for the appointment of an independent monitor for SRA, SRA Management Associates, SRA I LLC, SRA II LLC, SRA III, LLC, Clear Sailing Group IV LLC, and Clear Sailing Group V LLC. ECF 4. This Court granted the SEC's motion in March 2016, and appointed Michael Maidy of Sherwood Partners to serve as the Monitor. ECF 36. Mr. Maidy is the co-founder and co-managing member of Sherwood Partners.

In May 2016, Mr. Maidy lodged his final report with the Court as the Monitor. ECF 74. In that report, because of the significant financial harm that would be suffered by SRA Funds investors, Mr. Maidy strongly recommended against any liquidation plan that proposed to immediately liquidate the securities.

> Based on the Monitor's expertise and knowledge of pre-IPO technology companies, the Monitor does not recommend immediately attempting to liquidate the securities, due to the potential negative impact to investors. The underlying securities held by the Purchase Entities are illiquid and any distribution of the securities directly to individual investors is restricted (i.e. prohibited), so beneficial interests in privately held company securities would need to be sold for the benefit of investors rather than transferred directly to those investors. Further, sales of large blocks of privately held company securities into the marketplace prior to a liquidation event (i.e. an IPO or company sale) would likely be heavily discounted.

Id, at pp. 12-13.

Later in May 2016, the Court renewed Mr. Maidy's appointment and expanded the scope of the monitorship to include NYPA Fund I LLC, NYPA Fund II LLC, Felix Multi-Opportunity Fund I LLC, and Felix Multi-Opportunity Fund II LLC, thus placing all seven of the SRA Funds under Mr. Maidy's oversight as Monitor. ECF 91.

In October 2016, at the request of the SEC, the Court appointed Sherwood Partners as Receiver and placed all of the entities that were previously under Mr. Maidy's oversight as Monitor into receivership (the "Receivership Order"). ECF 141.[2] The Receivership Order requires the Receiver to serve as a court-approved fiduciary, and manage the SRA Funds in accordance with the original investment objectives of the SRA Funds pursuant to which the investors made their investment decisions. *See* ECF 141 at § IX. These investment objectives provide that when there is a "liquidity event," the Receiver is required to distribute the shares of the applicable SRA Funds' portfolio company holdings from each such liquidity event to the SRA Funds investors who purchased the membership interests in the SRA Funds that held those shares directly for the benefit of the investors. Additionally, it the Receiver seeks to sell or transfer shares of any pre-IPO companies held by an SRA Fund (i.e., prior to a "liquidity event"), the Receiver must first obtain specific Court approval authorizing the sale or transfer. The Receivership Order also requires the Receiver to develop a plan for the fair, reasonable and efficient recovery and liquidation of all remaining, recovered, and recoverable receivership property. *See id*., at § XIII.

In May 2017, the SEC reached a settlement in principle with all of the Defendants and Relief Defendants. While the settlement has not yet been presented to the Court, the Joint Distribution Plan proposed by the Receiver and the SEC does not contemplate making up any potential losses to SRA Funds investors stemming from the wrongdoing in the SEC complaint by requiring the Defendants or the Relief Defendants to pay for such losses.

[2] Also included within the receivership estate were Felix Management Associates LLC and NYPA Management Associates LLC, the managers of certain of the SRA Funds. *Id.*

In June 2017, the Receiver and the SEC filed the present motion for approval of the proposed Joint Distribution Plan. ECF 196-200. If approved, the Joint Distribution Plan proposed by the Receiver and the SEC will, in sum and substance:

1. Consolidate the assets and liabilities of all of the SRA entities and SRA Funds into a single account;
2. Dissolve the SRA entities and SRA Funds;
3. Terminate the management and advisory agreements between the SRA entities and SRA Funds;
4. Hire a banker to value and then immediately sell all securities currently being held by or on behalf of the SRA Funds (including all shares of pre-IPO companies, unless there is an impending liquidity event);
5. Pay the banker an as yet undisclosed fee, the expense of which would be borne by the SRA Funds investors who never approved the banker or the fee;
6. Pay all of the fees and expenses of the Receiver and its counsel; and then
7. Distribute funds, if any, remaining to all investors and creditors of the SRA entities and SRA Funds, regardless of the investment and regardless of the applicable SRA Fund.

See ECF 196-3, Ex. A.

The Receiver acknowledges that the Joint Distribution Plan will "depart from the original intended course of allocation of assets as set forth in the Order" initially appointing the Receiver. ECF 183 at 10. This is the main thrust of the Investor Group's objection. This departure will, according to the Investor Group, dramatically and negatively impact the ability of SRA Funds investors to maintain and profit from their investments in the SRA Funds as originally contemplated. There are other alleged deficiencies in the Joint Distribution Plan as well. Specifically, the Investor Group contends the Receiver and SEC have overstated the nature and

amount of any purported share "shortfall;" misconstrued the nature and monetary value of claims asserted against the receivership estate by one claimant, Global Generation Group; and proposed a distribution plan that treats some claimants better than others, while unfairly and unnecessarily harming SRA Funds investors who indirectly hold through the SRA Funds potentially valuable pre-IPO securities interests.

III. DISCUSSION

A. Legal Standard

This Court has equitable authority to formulate a distribution plan that is consistent with the purposes of the receivership it is charged to oversee in this case. The "primary purpose of equity receiverships is to promote the orderly and efficient administration of the estate by the district court for the benefit of creditors." *S.E.C. v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986). This Court's "power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad." *S.E.C. v. Capital Consultants, LLC*, 397 F.3d 733, 738 (9th Cir. 2005) (quoting *Hardy*, 803 F.2d at 1037)) (internal quotation marks omitted). "[T]he district court has broad powers and wide discretion to determine the appropriate relieve in an equity relationship." *Id* (quoting *S.E.C. v. Lincoln Thrift Ass'n*, 755 F.2d 600, 606 (9th Cir. 1978)) (internal quotation marks omitted). "The basis for this broad deference… arises out of the fact that most receiverships involve multiple parties and complex transactions." *Id* (quoting *Hardy*, 803 F.2d at 1037).

The Court's broad, inherent supervisory power over the receivership also is necessary to enable it to "fashion [a] distribution plan that is fair and equitable to the investors." *S.E.C. v. Am. Capital Investments, Inc.*, 98 F.3d 1133, 1144 (9th Cir. 1996), *abrogated on other grounds by Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83 (1998) (quoting 2 Clark on Receivers § 482 (3d ed. 1992)); *see also Capital Consultants*, 397 F.3d at 738–739. Liquidation of a receivership estate for this purpose is an option of last resort, and any such proposed liquidation must be carefully

scrutinized to ensure its fairness to investors. *See Los Angeles Deed Trust & Mortgage Exchange v. S.E.C.*, 285 F.2d 162, 182 (9th Cir. 1960); *see also S.E.C. v. Current Fin. Servs., Inc.*, 783 F. Supp. 1441, 1445 (D.D.C. 1992) (declining SEC.'s request to grant the receiver authority to liquidate, holding "[i]t would be premature at this stage to confer such broad powers."); *S.E.C. v. Path America, LLC*, Case No. C-15-1350-JLR, 2016 WL 1588384 (Apr. 20, 2016) (declining SEC's motion to liquidate commercial properties of receivership estate on "As-Is, "Where-Is" basis, and authorizing pursuit of alternative proposal advocated by investor groups to solicit prospective buyers that would build and develop the properties consistent the investment purpose of the project).

B. The Competing Distribution Plans

Here, the Court is of the opinion that the Joint Distribution Plan proposed by the Receiver and the SEC is not in the best interests of, nor fair and equitable to, SRA Funds investors.

Preliminarily, the Court notes that the Joint Distribution Plan appears to have been drafted without input from any SRA Funds investors and is not a model of clarity. The Receiver and the SEC appear to lack crucial information necessary to the implementation of a fair and equitable plan of distribution. The Receiver and the SEC apparently do not know, even at this late date: (i) the total amount raised from investors by the seven SRA Funds; (iii) the total number of investors with money still invested in the SRA Funds; or (iii) the total amount still invested by such investors in the SRA Funds. *See* Declaration of Jonathan K. Levine Decl., ¶ 5.

The Receiver and the SEC also have not yet appended a value (actual or even estimated) to their proposed Joint Distribution Plan. Although it is contemplated that a banker will be hired by the Receiver (at the ultimate expense of the SRA Funds investors), and that this banker will value and then sell the securities currently being held by or on behalf of the SRA Funds, they provide no information about who this banker is, how much the retention will cost, a minimum acceptable sales price, or the value of what the Receiver might receive for the receivership estate if the Joint Distribution Plan is implemented. How can SRA Funds investors, or the Court in its supervisory

capacity, assess the fairness of the proposed Joint Distribution Plan without knowing what it will cost to implement, and what monies, if any, will be generated if it ultimately is approved and underway? These uncertainties are fatal to the approval of the Joint Distribution Plan.

The Investor Group makes a number of important points in its objection to the Joint Distribution Plan as well. In particular, the Investor Group seems to have a better understanding of the reasons for and nature of the alleged shortfall in Square shares. Setting aside a misallocation of 16,808 shares that apparently occurred while Sherwood Partners was acting as the Monitor, the total known shortfall for all seven of the SRA Funds amounts to just 5,988 Square shares. Levine Decl., ¶¶ 6-8. The cost to cover this shortfall is approximately $152,574. *Id*. Whatever the reason for the shortfall, liquidating all $53 million of the SRA Funds and depriving investors of the value of their potentially valuable investments in order to fund this modest shortfall is akin to using a cannon to battle a house fly. There are, as the Investor Group's Alternative Plan of Distribution points out, far more equitable ways to cure these shortfalls than the Joint Distribution Plan proposed by the Receiver and the SEC.[3]

There also appears to be a superior way to fund a claim against the receivership by Global Generation Group, by construing that claim for what it is: a money judgment, and nothing more. Trying, as the Receiver and the SEC do in the Joint Distribution Plan, to reframe that judgment as an interest in Palantir shares, and then valuing those shares in such a way as to create a "shortfall" in Palantir shares, only hurts SRA Funds investors currently holding Palantir shares, and creates an undeserved windfall to Global Generation Group.

The proposal by the Receiver and the SEC to distribute funds, if any, remaining post-

[3] The Investor Group's Alternative Plan of Distribution also suggests an equitable way for the Receiver to cover the 16,808 Square share shortfall that it caused, by either trying to get back the shares it over-distributed to investors (at the Receiver's expense), or by having the Receiver's fee reduced to cover this shortfall.

liquidation and after payment of all valid claims against the estate, also presents inequities. Most critically, it allows for a *pro rata* claim by an investor who assumed the risk of losing its investment in a failed company, even though that investor would not be entitled to any return on its investment under the original investment documents. And, by pooling the funds and giving *pro rata* distributions to claimants who have no entitlement to the securities remaining in the SRA Funds, investors who continue to hold investments in companies that remain part of the SRA Funds are harmed as well: their investment shares would be diminished to pay *pro rata* payments to those who had failed investments. This is quite evidently contrary to the original investment purposes of the SRA Funds – a point the Receiver and the SEC properly concede in their filing.

The Investor Group has proposed an Alternative Plan of Distribution that avoids these inequities. In fairness to the Receiver and the SEC, the Investor Group has the advantage of having secured financial commitments from certain SRA Funds investors to satisfy legitimate claims against the receivership estate to the extent such claims, in the aggregate, do not exceed $5 million. *See* Levine Decl., ¶ 4. This advantage enables the Investor Group to propose a plan that will allow a new manager to take over the SRA Funds so that the SRA Funds may continue to operate a originally planned to achieve the investment objectives of the SRA Funds and the individual SRA Funds investors. *See* Declaration of Joshua Cilano ¶ 4. An independent advisory committee, made up of selected SRA investors that include an attorney, experienced investment professionals, certified public accountants, and other financial professionals, is being proposed to monitor and oversee the operation of the SRA Funds. An independent certified public accounting firm is proposed to provide tax and accounting services to the SRA Funds. Although the Investor Group proposes that the existing receivership be terminated, the Alternative Distribution Plan proposes that the new fund manager will have ongoing reporting responsibilities to SRA Funds investors, as well as the SEC and the Court (as appropriate). *Id*, ¶ 8.

IV. CONCLUSION

On balance, the Court finds that the Alternative Plan of Distribution proposed by the Investor Group is sensible, provides an appropriate mechanism to pay legitimate claims of creditors, and sets forth a distribution plan that is fair and equitable to SRA Funds investors. Of further note, the vast majority of SRA Funds investors support the Alternative Distribution Plan, while no SRA Funds investor has come forward to support the Joint Distribution Plan proposed by the Receiver and the SEC.

Based on the foregoing analysis, the Court DENIES the Receiver's and the SEC's Motion for Approval of a Joint Distribution Plan. The Court DIRECTS that the Investor Group, within ten (10) days of entry of this Order, prepare and submit to the Court a formal order and time table for implementing the Alternative Plan of Distribution described in the Investor Group's submission.

The Receiver is ORDERED to take any and all necessary steps to allow for the transition of management of the SRA Funds to a new manager to be proposed by the Investor Group and approved by the Court. The Court encourages the Investor Group to confer and consult with the SEC with respect to any proposed implementation timetable. The Court will hold a further hearing on _____, 2017 at _____ __.M, to address implementation concerns, if any.

The Court will address the request of the Receiver for an order awarding it and its counsel fees and expenses by separate order. In fashioning that order, the Court will consider efforts by the Receiver to recover for the receivership estate any Square shares that were over distributed to SRA Funds investors during the tenure of the monitorship or receivership.

IT IS SO ORDERED.

Dated: _____

_____
Judge Edward M. Chen
United States District Court