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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

JOHN V. BIVONA, et al.,

Defendants.

Case No. [16-cv-01386-EMC](#)

**ORDER REGARDING PLAINTIFF SEC
AND RECEIVER’S REQUEST FOR
PRELIMINARY FINDINGS RELATED
TO PROPOSED JOINT DISTRIBUTION
PLAN**

Docket Nos. 196-197

Plaintiff SEC and the Receiver have jointly moved for approval of a proposed distribution plan involving the consolidation, liquidation, and distribution of the Receivership Assets to investors on a *pro rata* basis. *See* Docket Nos. 196, 197. By stipulation of the parties and this Court’s order, the approval process has been bifurcated to assist the parties’ discussions about potential distribution plans. *See* Docket No. 208.

At the first step of the approval process, the SEC and the Receiver request the Court make preliminary findings that (a) Defendants commingled investor funds; (b) Defendants diverted investor cash to themselves or otherwise violated provisions of the federal securities laws, and (c) Defendants’ conduct would justify the termination of the management agreements and the exclusion of Defendants and certain specified insiders from recovery through the proposed distribution plan. *Id.* A hearing on the first step was held on August 30, 2017, at which the Court heard from the SEC and the Receiver, as well as two objectors to the request for preliminary findings. The first objector was third-party investor TeleSoft Capital LLC (“TeleSoft”), who objects to findings of commingling or diversion of funds with respect to its own investment. *See* Docket Nos. 210, 226. The second objection was filed by Defendants John Bivona and Saddle

1 River Advisors LLC, arguing that a finding of wrongdoing without trial would violate their due
2 process rights, and by Relief Defendant Anne Bivona, arguing that she should not be barred from
3 making a claim to recover the balance of a loan she made to Defendants because she has not been
4 accused of wrongdoing. *See* Docket No. 212.

5 The second step of the approval process will address the merits of the SEC and Receiver's
6 distribution plan itself, any objections thereto, as well as any alternative proposals filed by
7 interested parties. The hearing on the second step is scheduled for September 28, 2017. Thus far,
8 one alternative distribution plan has been filed by a group of investors with claims to 79% of the
9 funds still invested. *See* Docket No. 229.

10 This order addresses only the first step of the process, the parties' request for preliminary
11 findings and objections to those findings. However, because the requested findings will be
12 material to the Court's analysis of the proposed distribution plans at the second step, the Court will
13 first provide an overview of the current stage of proceedings and the legal framework governing
14 the distribution of assets by a receiver in securities fraud cases.

15 I. BACKGROUND

16 The SEC filed this action alleging that Defendant John Bivona, his son-in-law Defendant
17 Frank Mazzola, and affiliated Defendants Saddle River Advisors, LLC and SRA Management
18 Associates, LLC raised approximately \$53 million from investors. A number of Relief
19 Defendants, including Mr. Bivona's spouse Anne Bivona, were also named.¹ Defendant Bivona
20 allegedly commingled and diverted investor proceeds contrary to the promises he made to
21 investors. Specifically, Defendants allegedly promised investors that their money would be used
22 to buy shares in certain pre-IPO companies and to pay specified fees for their acquisition. Bivona,
23 however, allegedly used the money to cover share purchase obligations to earlier investors in
24 unrelated funds; attempted to disguise his conduct by transferring money in and out of multiple
25 bank accounts; used \$5.7 million of the funds to pay for personal and family expenses; and failed

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¹ The other Relief Defendants are: SRA I LLC; SRA II LLC; SRA III LLC; Felix Investments
LLC; Michele J. Mazzola (Frank Mazzola's spouse); Clear Sailing Group IV LLC, and Clear
Sailing Group V LLC.

1 to provide investors with promised financial statements.

2 A. Procedural History and Appointment of Receiver

3 On March 25, 2016, based on these allegations and supporting affidavits, the Court granted
 4 a temporary restraining order that, among other things, froze certain assets belonging to
 5 Defendants and Relief Defendants and appointing Michael A. Maily as an Independent Monitor.
 6 *See* Docket No. 36. In the order, the Court found that the SEC had presented “evidence
 7 establishing a prima facie case and a reasonable likelihood of prevailing on its claims that
 8 Defendants John V. Bivona, Saddle River Advisors, LLC, and SRA Management Associates have
 9 engaged in, are engaging in, are about to engage in, and will continue to engage in, unless
 10 restrained . . . transactions, acts, practices and courses of business that constitute violations” of
 11 various securities laws, and that Relief Defendants were “in possession of the proceeds of those
 12 violations and have been unjustly enriched by such receipt.” *Id.* at 1-2.

13 On May 3, 2016, all Defendants and Relief Defendants, except for Defendant Frank G.
 14 Mazzola and Relief Defendant Michele Mazzola, stipulated to granting the SEC’s motion for
 15 preliminary injunction, which confirmed the terms of the earlier temporary restraining order.
 16 Docket No. 68. On May 25, 2016, the Court granted the motion for preliminary injunction with
 17 respect to the Mazzolas “[f]or the same reasons the SEC was able to satisfy the requirements for a
 18 TRO.” Docket No. 96 at 4.

19 On October 11, 2016, the Court approved a stipulation between the SEC, Defendants John
 20 V. Bivona, Saddle River Advisors LLC, and SRA Management, LLC, and Relief Defendants SRA
 21 I LLC, SRA II LLC, SRA III LLC, Clear Sailing Group IV LLC, and Clear Sailing Group V LLC-
 22 that “the appointment of a receiver is appropriate.” Docket No. 142. The Court found that “based
 23 on the record in these proceedings, the Independent Monitor’s reports to the Court and the parties’
 24 Stipulation, the appointment of a receiver in this action is necessary and appropriate for the
 25 purposes of marshaling and preserving all assets of the Receivership Defendants [and certain other
 26 affiliated entities].” *Id.* at 2. Sherwood Partners was appointed Receiver.² The Receiver was

27 _____
 28 ² The Receivership Defendants include Saddle River Advisor, LLC’s holding companies (SRA I
 LLC, SRA II LLC, SRA III LLC (the “SRA Funds”)) and Clear Sailing IV and Clear Sailing V

1 authorized to “transfer, compromise, or otherwise dispose of any Receivership Property, other
 2 than shares of pre-IPO companies, in the ordinary course of business, on terms and in the manner
 3 the Receiver deems most beneficial to the Receivership Estate, and with due regard to the
 4 realization of the true and proper value of such Receivership Property.” *Id.* at 10. The Order
 5 further provided that if a “liquidity event” occurred “for a particular Series of company shares, the
 6 Receiver may, subject to court approval, carry out a distribution of the proceeds of the liquidity
 7 event after making a reasonable effort to identify all investors in those shares.” *Id.* The Receiver
 8 was also authorized “subject to Court approval, [to] negotiate for the sale or transfer of shares of
 9 pre-IPO companies,” and, with further Court approval “to sell, and transfer clear title to, the shares
 10 of the pre-IPO companies.” *Id.*

11 Because the Receiver was appointed by stipulation, there was no need for the Court to
 12 make formal factual findings in appointing the Receiver.³ There is no dispute such appointment
 13 was appropriate.

14 Further, the parties have apparently reached a settlement resolving the underlying claims in
 15 this case. *See* Docket No. 223. If the settlement is approved, then the administration of the
 16 receivership will be the last remaining issue to resolve.

17 B. The Receiver’s Investigations

18 Since its appointment as Receiver, Sherwood has investigated the assets of Defendants and
 19 Relief Defendants. *See* Docket Nos. 168 and 183. It has identified each investor in the Relief
 20 Defendant funds (“SRA Investors”), the amount of capital each investor asserts they invested in
 21 SRA, the amount actually invested, and the documentary support for those investments.
 22 Hartheimer Decl. ¶ 4. Both the Receiver and the SEC have also reviewed Defendant and Relief

23
 24 (the “Clear Sailing Funds”).

25 ³ *See, e.g.*, Fed. Prac. & Proc. § 2983 (“Factors that courts have considered relevant to
 26 establishing the requisite need for a receivership include the following: fraudulent conduct on the
 27 part of defendant; the imminent danger of the property being lost, concealed, injured, diminished
 28 in value, or squandered; the inadequacy of the available legal remedies; the probability that harm
 to plaintiff by denial of the appointment would be greater than the injury to the parties opposing
 appointment; and, in more general terms, plaintiff’s probable success in the action and the
 possibility of irreparable injury to his interests in the property.”).

1 Defendants' bank account and corporate records. Hartheimer Decl. ¶¶ 4, 19. The Receiver did
 2 not discover any creditors, but found other lawsuits against Defendants and Relief Defendants
 3 implicating the Receivership's assets, including at least one judgment. Hartheimer Decl. ¶¶ 16-17.

4 The Receiver's analysis of the Receivership Assets and Defendants' records is summarized
 5 below.

6 1. Unreliability of Records

7 The Receiver reports that Defendants' records are unreliable, making a thorough audit of
 8 the source of all investments impossible. Receiver's Mot. At 9 (citing Hartheimer Decl. ¶ 19).
 9 Defendants' accountant has described Defendants' operations as "willy nilly," claiming
 10 Defendants' records were prepared by an "unqualified bookkeeper" he "did not trust." Hartheimer
 11 Decl. ¶ 20. Due to the unreliability of the records, the Receiver claims that "any attempt to
 12 determine the source of the funds used by each Relief Defendant to make purported investments
 13 into the various pre-IPO companies . . . is not feasible." Receiver's Mot. at 9 (citing Hartheimer
 14 Decl. ¶ 19).

15 As an example of the unreliability of Defendants' records, the Receiver points to a shortfall
 16 of shares in the technology company Square, Inc. ("Square"). Investors in the Receivership
 17 Defendants appear to be entitled to more Square shares than are available for distribution, the
 18 shortfall apparently amounting to 9,799.72 shares with a present value estimated at \$236,271.
 19 Nertea Decl. ¶ 3. The shortfall suggests that, prior to the appointment of the Receiver, there was
 20 an over-distribution of 16,808 shares to investors. Receiver's Mot. at 10. The Receiver has been
 21 unable to reconcile the disparity through conversations with Bivona or by reviewing Defendants'
 22 spreadsheets. Nertea Decl. ¶¶ 2-4. The objecting Investor Group contends that any shortage of
 23 Square shares is attributable to the Monitor's errors, not to any of Defendants' alleged misconduct,
 24 but that dispute was not addressed at the August 30, 2017 hearing and is not material to this order.
 25 See Docket No. 229 at 7.

26 As further evidence of the unreliability of records, the Receiver also points to a shortfall
 27 with respect to the pre-IPO shares of Palantir. Previously, the Monitor was unable to reconcile the
 28 number of Palantir shares allegedly purchased by SRA investors with the number of Palantir

1 shares reflected in Receivership Defendants' "Purchased Spreadsheet." *See* Docket No. 120 at 5-
2 6. The SEC's most recent investigations suggest that the total shortfall for Palantir appears to be
3 over 300,000 shares. The Receiver contends that the manner in which they uncovered this
4 discrepancy offers further support for the unreliability of Defendants' records. Initially,
5 Defendants' records suggested that they held an *excess* of 170,008 shares in Palantir, but a later
6 investigation uncovered that TeleSoft had a claim to 227,000 shares of Palantir that was not
7 reflected in Defendants' records. *See* Docket No. 74 at 11; Docket No. 120 at 5-6, Hartheimer
8 Decl. ¶ 13. The SEC and the Receiver also learned that investor Global Generation Group LLC
9 had made a \$6.3 million investment with Defendants, \$2.8 million of which was intended for
10 933,000 shares of Palantir. Global claimed the shares had never been delivered in kind or in cash
11 value, and has already reduced that claim to a judgment. *See* Receiver's Mot. at 13; Hartheimer
12 Decl. ¶¶ 16-17. The objecting Investor Group disputes whether there is a shortfall of Palantir
13 shares based on their disagreement of how Global Generation Group's claim should be
14 categorized, but that dispute will be addressed at the September 28, 2017 hearing. *See* Docket No.
15 229 at 13-15.

16 The Receiver maintains that these two examples highlight the unreliability of Defendants'
17 records and the impossibility of successfully tracing all investor funds. Defendants and the
18 objectors have not disputed the claim that Defendants' records are generally unreliable, however,
19 the objecting Investor Group disputes whether the Palantir shortfall exists and whether the Square
20 shortfall is attributable to Defendants or to the Monitor. *See* Docket No. 229. That dispute will be
21 heard on September 28, 2017 and is immaterial to the issues decided in this order.

22 2. Evidence of Commingling

23 The SEC's investigation, as summarized in the declaration of Ellen Chen, *see* Docket No.
24 14, also identifies evidence that investor funds were regularly commingled, and that funds were
25 regularly transferred between the various Defendant and Relief Defendant entities. Ms. Chen
26 identified more than one instance in which Defendant SRA Management used investor funds from
27 one Relief Defendant fund to cover share purchase commitments of pre-IPO companies obligated
28 by other Relief Defendant funds, including shares in Palantir and other companies. Chen Decl.

1 ¶¶ 36-43. In many cases, one Relief Defendant’s investments were funded by another Relief
2 Defendant’s funds. *See* Chen Decl. ¶¶ 87-124. Further, Defendant Bivona gave testimony before
3 the SEC that sometime in 2012, after the SEC began its investigation into the Felix Multi
4 Opportunity Funds (“FMOF”), he moved all the 13 funds to one bank account in his name.
5 Receiver’s Mot. at 15.

6 Defendants do not object to a finding that funds were commingled, in the simple sense that
7 common bank accounts were used or that shares were held in common pools. At the hearing,
8 Defendants’ counsel simply argued that there should be no finding that the commingling was
9 “nefarious” because the lending of money between the funds was purportedly permissible
10 according to the governing documents of those entities. To make a finding of illegality without a
11 trial would violate their due process rights, they contend. *See* Docket No. 212. Thus, Defendants
12 object only to any finding that such transactions between the funds were a form of wrongdoing or
13 unlawful conduct.

14 Only TeleSoft objects to the SEC and Receiver’s request for a finding of commingling.
15 TeleSoft does not challenge that Defendants may have generally engaged in commingling of
16 funds, but argues that its investment (or, in the alternative, at least, \$1,022,000 out of \$1,475,500)
17 was not commingled. *See* Docket Nos. 210, 226. Its objection is discussed below.

18 3. Evidence of Diversion of Funds

19 The SEC also claims its investigation revealed evidence that Defendants regularly diverted
20 investor funds. For example, SRA funds were used to pay for law firms and attorneys for work
21 unrelated to the SRA funds on more than one occasion. Chen Decl. ¶¶ 27-30. Similarly, expenses
22 of one Relief Defendant were often paid with another’s funds. *Id.* The SEC also claims
23 Defendants expended \$2,307,076 in management fees in excess of the amounts permitted by their
24 respective governing documents. *See* Chen Decl. ¶ 26.

25 The Receiver relied on these SEC findings and others to conclude that Defendants “may
26 have misappropriated for personal expenses, up to \$5.7 million for which there is inadequate
27 documentation,” excluding “amounts used for Ponzi-like payments to other investors or to fund
28 the investments of other Relief Defendants.” *See* Docket No. 196 (“Receiver’s Mot.”) at 7.

1 As explained above, Defendants object to any finding that they diverted funds in an
 2 unlawful manner, arguing a finding of wrongdoing would violate their due process rights if made
 3 before trial. *See* Docket No. 212. As above, TeleSoft also objects to any finding that moneys
 4 from its investment were diverted, but it does not object to a finding with respect to other
 5 investors. *See* Docket Nos. 210, 226.

6 4. Exclusion of Defendants and Insiders

7 The SEC and the Receiver also ask the Court for a preliminary finding that the following
 8 entities and individuals, who it describes as Defendants, Relief Defendants, owners, or insiders,
 9 will be excluded from the recovery under its proposed plans.

- 10 • John V. Bivona - Defendant
- 11 • Frank Mazzola - Defendant
- 12 • Anne Bivona - Relief Defendant
- 13 • Michele Mazzola - Relief Defendant
- 14 • David Jurist⁴ - Alleged Insider
- 15 • Alice Jurist - Alleged Insider
- 16 • Former agents or employees of Saddle River Advisors, Felix Investments, FMOF
 Management, NYPA Management, SRA Management, Clear Sailing IV and Clear
 Sailing V and the Fortuna Fund Management - Alleged Insiders
- 17 • Other alleged insiders (including Emilio DiSanluciano⁵)

18 *See* Proposed Plan of Distribution at 6-7 (Docket No. 196).

19 No Defendant or alleged insider has objected to the proposal to bar them from filing any
 20 claims against the Receivership Assets. Only Relief Defendant Anne Bivona objects, arguing
 21 there is no basis to bar her from making a claim for the balance of a \$1.4 million loan she made to
 22 Defendants to complete the purchase of shares for investors. *See* Docket No. 212. Her objection
 23 is discussed in more detail below.

24 ⁴ David Jurist is allegedly an insider who received at least \$75,000 from Clear Sailing Group IV.
 Ip Decl. ¶ 17.

25 ⁵ The SEC claims that “Mr. DiSanluciano actively participated in deceptive sales to investors
 26 such as Telesoft Ventures and received large commission payments from investor money,
 including the purchase and sale of Palantir shares in November 2011. Mr. Jurist was a manager of
 27 Clear Sailing and signed the checks for undisclosed payments in November 2011 using money
 taken from Global Generation and Progresso Ventures.” SEC Reply at 4, n.3. He received at least
 28 \$856,233 through an entity he owns called Thorsdale Inc. *See* Ip Decl. ¶ 17. He was also a
 manager of FB Management and FMOF II, two of the entities involved in the fraudulent scheme.

II. DISCUSSION

A. Legal Standard

The Court previously appointed the Receiver with Defendants' stipulation; no party objected to the appointment of the Receiver. *See* Docket No. 142. The question now before the Court is limited to how the Receiver should manage the assets under its control, including the manner of their distribution. The "primary purpose" of a receivership is "to promote orderly and efficient administration of the estate by the district court for the benefit of creditors." *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986) (citation and quotation omitted). The district 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." *Id.* at 1037. The basis for that broad authority is that "most receiverships involve multiple parties and complex transactions." *Id.* As the Ninth Circuit has explained,

[a] district judge supervising an equity receivership faces a myriad of complicated problems in dealing with the various parties and issues involved in administering the receivership. Reasonable administrative procedures, crafted to deal with the complex circumstances of each case, will be upheld. A district judge simply cannot effectively and successively supervise a receivership and protect the interests of its beneficiaries absent broad discretionary power. We would be remiss were we to interfere with a district court's supervision of an equity receivership absent a clear abuse of discretion.

Id. at 1038.

In exercising its equitable powers, the Court must ultimately determine how the Receivership's assets should be distributed to Defendants' investors and creditors. In reviewing a prospective plan, the Court must "satisf[y] itself that the distribution of proceeds . . . is fair and reasonable." *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991).

B. Analysis

First, the Court will address the SEC and Receiver's request for preliminary findings that Defendants commingled and diverted investor funds or otherwise violated the securities laws, and Defendants John Bivona and Saddle River Advisor's LLC's objection that findings of wrongdoing without a trial would violate their due process rights. As explained below, in many securities

1 fraud cases, courts have adopted *pro rata* distribution plans based, in part, on their determination
2 that tracing was not feasible because of commingling by defendants or other problems with
3 record-keeping. Findings of wrongdoing are not necessary to the distribution of Receivership
4 Assets (under whatever plan is ultimately adopted). First, Defendants do not challenge the
5 Receiver's ability to distribute the assets. Moreover, the cases authorizing distribution focus on
6 whether assets were pooled such that assets cannot accurately be traced or it is not feasible to
7 distribute assets in an equitable manner. *See, e.g., SEC v. Byers*, 637 F.Supp.2d 166, 179
8 (S.D.N.Y. 2009); *S.E.C. v. Sunwest Mgmt.*, 2009 U.S. Dist. LEXIS 93181, at *29 (D. Or. Oct. 2,
9 2009). Thus, the Court will not reach the issue of whether Defendants engaged in wrongful
10 conduct at this time. The Court will instead limit its analysis to whether funds and stocks were
11 pooled in common such that tracing will either be impossible or inequitable.

12 Second, the Court will turn to the SEC and Receiver's joint request to exclude Anne
13 Bivona from making a claim against the Receivership. For the reasons explained below, whether
14 Ms. Bivona should be excluded will depend upon the resolution of disputed facts. The Court will
15 schedule an evidentiary hearing in connection therewith.

16 1. Request for Findings of Commingling, Diversion of Funds, or Other Violations of
17 the Securities Laws

18 a. Principles Governing Distribution of Receivership Assets

19 A key threshold issue in determining the most equitable distribution plan will be whether
20 the Receivership's Assets are adequate to satisfy the claims of all investors and creditors, an issue
21 that is disputed by the objecting Investor Group but which will not be addressed until the
22 September 28, 2017 hearing. The resolution of that dispute will likely play a significant role in
23 fashioning the appropriate distribution plan here because the fundamental problem in many
24 securities fraud cases arises when the assets available for distribution are insufficient to fully
25 compensate all investors and creditors with legitimate claims. There are few hard-and-fast rules
26 for how courts should exercise their equitable discretion in such circumstances, but one deeply
27 engrained principle holds that where multiple people have been victimized, "all victims of the
28 fraud be treated equally." *United States v. Real Property Located at 13328 and 13324 State*

1 *Highway 75 North*, 89 F.3d 551, 553 (9th Cir. 1996) (citation omitted). This principle traces its
2 origin at least to *Cunningham v. Brown*, 265 U.S. 1, 13 (1924), the original Ponzi-scheme case in
3 which the Supreme Court refused to permit creditors to trace their debts to recover from the
4 remaining assets because doing so would come at the expense of similarly-situated victims.
5 Instead, the Supreme Court held that the victims “were all of one class, actuated by the same
6 purpose to save themselves from the effect of Ponzi’s insolvency,” and that, therefore, it was a
7 case that “call[ed] strongly for the principle that equality is equity.” *Id.*

8 If the available shares and/or funds are insufficient to fully compensate all investors, this
9 principle has implications for how the Receivership Assets should be distributed to the victims in
10 this case. In such a case, one possible distribution method would involve the apportionment of
11 available assets on a *pro rata* basis to all investors, as advocated by the SEC and the Receiver.
12 Another method would permit investors to “trace” their investment to a discrete portion of the
13 remaining assets, and claim that amount. In situations involving mismanagement, poor record-
14 keeping, or diversion of investor funds, it is often difficult if not impossible to successfully trace
15 all claims. Indeed, that is the basis the SEC and the Receiver have cited here for to request a *pro*
16 *rata* distribution. *See* Receiver’s Mot. at 15 (arguing that “consolidation of the assets of the Relief
17 Defendants is appropriate because there is no equitable means of allocating ownership among the
18 Relief Defendants” and segregation of the assets “would result in similarly situated investors
19 receiving unequal distributions”). If a particular investor who is able to “trace” his or her
20 investment is permitted to do so, other victims will end up receiving a smaller portion of whatever
21 remains. In effect, the investor who obtains relief based on tracing will obtain preferential
22 treatment vis-à-vis other investors. The Eleventh Circuit has explained:

23 To allow any individual to elevate his position over that of other
24 investors similarly ‘victimized’ by asserting claims for restitution
25 and/or reclamation of specific assets based upon equitable theories
26 of relief such as fraud, misrepresentation, theft, etc. would create
27 inequitable results, in that certain investors would recoup 100% of
28 their investment while others would receive substantially less. . . .
[I]n the context of this receivership the remedy of restitution to
various investors seeking to trace and reclaim specific assets as
originating with them is disallowed as an inappropriate equitable
remedy.

1 *S.E.C. v. Elliott*, 953 F.2d 1560, 1569 (11th Cir. 1992).⁶ For that reason, courts generally “will not
2 indulge in tracing when doing so would allow one fraud victim to recover all of his losses at the
3 expense of other victims.” *U.S. v. Wilson*, 659 F.3d 947, 956 (9th Cir. 2011). *See also*
4 *Commodity Futures Trading Comm’n v. Topworth Int’l, Ltd.*, 205 F.3d 1107, 1115-16 (9th Cir.
5 1999) (affirming approval of pro rata distribution where assets were commingled); *Real Property*,
6 89 F.3d at 553 (affirming pro rata distribution as more equitable method despite traceability of
7 some assets).

8 That rationale is bolstered by the fact that, typically, whether an investor is able to trace his
9 or her funds is a matter of luck: for example, a defendant’s records happen to be intact for that
10 investor, or a defendant has not yet spent that investor’s funds. That mere fortuity, however, is not
11 viewed an equitable basis to favor some claims over others, particularly where doing so would
12 harm other investors. *See Elliott*, 953 F.2d at 1569 (holding that “the equities weigh against
13 allowing some to benefit from the fortuity that [defraudor] had not sold all of the securities”
14 sought); *U.S. v. Durham*, 86 F.3d 70, 73 (5th Cir. 1996) (affirming district court’s refusal to trace
15 funds on basis that it would permit some investors “to benefit merely because the defendants spent
16 the other victims’ funds first”); *SEC v. Byers*, 637 F.Supp.2d 166, 179 (S.D.N.Y. 2009) (finding
17 that “it is merely a coincidence that [some] [f]unds were not commingled as extensively as
18 [others] – and coincidence cannot be a basis to treat th[ose funds’] investors more favorably than
19 the [other] investors”); *S.E.C. v. Credit Bancorp, Ltd.*, 194 F.R.D. 457, 463-64 (S.D.N.Y. 2000)
20 (rejecting investor’s attempt to compel return of unencumbered shares and full amount of dividend
21 because “it is only a matter of chance . . . that [its] assets were not dissipated in lieu of those of its
22 fellow customers”).

23 To be sure, some courts have authorized tracing in circumstances where traceability was
24

25 _____
26 ⁶ *See also S.E.C. v. Path America, LLC*, No. C15-1350JLR, 2016 WL 1385144, at *2 (W.D.
27 Wash. Apr. 6, 2016) (declining to permit investor to “jump ahead of all other investors and
28 creditors with respect to any future distribution by the Receivership estate,” since all had been
“victimized by the fraud”); *SEC v. Capital Cove Bancorp LLC*, No. SACV 15-980-JLS (JCx),
2015 WL 9701154 at *11 (C.D. Cal. Oct. 13, 2015) (rejecting effort to trace property because
“[a]llowing various investors to trace and reclaim specific assets” where many victims were
involved and funds were commingled would be inequitable (quotation omitted)).

1 not simply a function of chance, but rather, due to true constraints on the defendant’s control or
2 use of the funds. *See, e.g., Anderson v. Stephens*, 875 F.2d 76, 77-80 (4th Cir. 1989) (permitting
3 return of funds deposited after district court had frozen entity’s assets and entity had ceased doing
4 business); *S.E.C. v. Black*, 163 F.3d 188, 196-97 (3d Cir. 1998) (affirming return of assets held in
5 custodian accounts that were never pooled or under defrauder’s control); *cf. City of Philadelphia v.*
6 *Lieberman*, 112 F.2d 424, 426 (3d Cir. 1940) (ordering return of assets placed in actual trust
7 account beyond insolvent entity’s control). These situations appear to be limited to contexts
8 where the assets sought were segregated or handled in a manner where the traceable proceeds
9 were placed beyond the control of the defrauding entity. *See S.E.C. v. Credit Bancorp, Ltd.*, 290
10 F.3d 80, 90 (2d Cir. 2002) (recognizing that in some cases “the reason the assets were returned
11 was not merely because they were traceable, but because the assets had been segregated in the
12 manner of true trust accounts and/or had never been placed in the defrauder’s control”); *Anderson*,
13 875 F.2d at 77-80 (deposit made after assets had been frozen).

14 Even where tracing is possible, courts retain the equitable discretion to employ other
15 means of distribution of assets. *See, e.g., Durham*, 86 F.3d at 71-73 (affirming district court’s use
16 of pro rata distribution despite traceability of assets and observing that “[n]o one can dispute that
17 tracing would have been permissible under the circumstances”); *S.E.C. v. Forex Asset Mgmt. LLC*,
18 242 F.3d 325, 331-32 (5th Cir. 2001) (affirming district court’s use of pro rata method even where
19 assets were indisputably segregated and observing that “[w]hile it may have been permissible in
20 the present case for the district court to have allocated all of the segregated funds to the
21 [objector],” the trial court was not “required to choose the equitable remedy requested by [the
22 objector]”).

23 These cases demonstrate that the feasibility of tracing and the presence of commingling,
24 even if proven, do not require the court to adopt a particular distribution scheme. Rather, the
25 Court must consider the situation as a whole, including how a particular plan might affect
26 similarly situated victims, to determine the most equitable distribution method.

27 b. Findings of Wrongdoing Are Not Required

28 Against that backdrop, the Court proceeds to review the SEC and Receiver’s joint request

1 for findings that Defendants engaged in commingling and diversion of funds or other violations of
2 the securities laws. Defendants John Bivona and Saddle River Advisors have objected to the
3 request, arguing that findings they violated the securities laws, diverted funds, or engaged in
4 “nefarious” commingling of funds, aside from being unnecessary, would violate their due process
5 rights if made before a trial.

6 Defendants’ due process claim need not be resolved because, as explained below, the
7 findings of wrongdoing requested by the SEC and Receiver are not required here. The Court is
8 not deciding *whether* to distribute the assets, but *how* to distribute them. Had Defendants not
9 consented to distribution of the assets, the Court would perhaps have been required to resolve the
10 SEC’s allegations of wrongdoing. *See, supra*, note 3. Given Defendants do not dispute the
11 propriety of a distribution, the Court need only decide what distribution method should be used
12 here. In doing so, the issue is not whether Defendants engaged in wrongdoing, but rather the
13 fairness of the method itself to investors and creditors. Although it is true that many of the cases
14 discussing the *pro rata* method refer to commingling against the backdrop of a fraudulent scheme,
15 the focus on commingling in these cases relates to determining whether investor monies can be
16 meaningfully and fairly distinguished, not the legal culpability of the defendants. For example, in
17 *Byers*, the court approved a pro rata distribution. In so doing, it rejected some investors’ argument
18 “that their money cannot have been commingled” because it “presumes” the remaining money was
19 “‘their’ money” when, because of commingling, it “in all likelihood” included other investor
20 money. 637 F.Supp.2d at 179. Thus, the pertinent factor was not the defendants’ wrongdoing, but
21 rather the effect it had on the court’s ability to distinguish what money belonged to which investor.
22 Similarly, in *Sunwest Management*, an objector argued that the distribution should be based on
23 which property each investor had invested in. The court overruled the objection in favor of
24 consolidating all the investments made in all the different properties, because the evidence showed
25 that “funds were taken from one property for use on another regardless of whether the funding
26 property had positive or negative cash flow or value.” 2009 U.S. Dist. LEXIS 93181, at *29. This
27 mingling of money meant that defendants had not treated the investments as segregated on a
28 property-by-property basis, and thus it was not possible to assume that the money in a particular

1 property at any time actually came from the investors in that property.

2 Similarly, it is unnecessary to determine whether Defendants diverted funds in an unlawful
 3 manner. Many of the cited cases approving pro rata distributions did not involve diversion of
 4 funds. *See Byers*, 637 F.Supp.2d at 181-82 (approving pro rata distribution without discussion of
 5 whether diversion of funds for personal benefit occurred); *Sunwest Mgmt.*, 2009 U.S. Dist. LEXIS
 6 93181 (same). It follows that a finding of diversion of funds is not a per se requirement to adopt a
 7 *pro rata* distribution method. That makes sense. What matters is whether there is a shortage of
 8 assets, not necessarily the reasons for the shortage. Whether a shortage results from unlawful
 9 conduct does not change the fact that there are insufficient funds to fully compensate all investors.
 10 And “when funds are limited, hard choices must be made.” *Official Comm. of Unsecured*
 11 *Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 84 (2d Cir. 2006) (quotation omitted). The
 12 court, sitting in equity, must thus determine how to distribute the remaining funds fairly. At this
 13 juncture, the reason for a purported shortfall of assets (*i.e.*, whether it was caused by Defendants’
 14 alleged diversion of funds or violation of the securities laws) does not appear to be material to the
 15 fairness analysis for the distribution method.⁷

16 Accordingly, the Court need not, and at this time will refrain from, making findings that
 17 Defendants violated the law or engaged in wrongful behavior. The Court will instead analyze
 18 allegations of commingling and the diversion of funds only to the extent those factors shed light
 19 on whether tracing is a feasible or equitable option in this case. The Court reiterates that another
 20 critical question is whether there is actually a shortfall of assets; that issue is not yet ripe for
 21 review, but rather, will be addressed at the September 28 hearing.

22 c. Investor Funds Were Commingled

23 The Court first reviews the extent to which funds were commingled. The Court considers
 24 the extent to which funds were commingled in the plain sense; *i.e.*, “put together . . . into one
 25

26 ⁷ Defendants have disclaimed any right to file claims with the Receiver. Thus, whether it would
 27 be permissible to enter such findings for the limited purpose of excluding Defendants from
 28 distributions by the Receiver is not before the Court. Only Relief Defendant Anne Bivona objects
 to her prospective exclusion; that issue is addressed below but it is irrelevant to the question here
 because Ms. Bivona has not been accused of unlawful conduct in the underlying case.

1 mass” or “mix[ed].” *See* Commingle, Black’s Law Dictionary (10th ed. 2014). The purpose is to
2 determine whether the source and destination of each investor’s funds can be meaningfully
3 disentangled.

4 There are no clear appellate or Supreme Court precedents setting forth whether a minimum
5 threshold of commingling is required to conclude that it has occurred, let alone what that threshold
6 should be. Several courts, however, have found that, under equitable principles, *any* commingling
7 is sufficient. *See, e.g., Sunwest Mgmt.*, 2009 U.S. Dist. LEXIS 93181 at *34 (“Due to the
8 fungibility of money . . . courts have held that any commingling is enough to warrant treating all
9 of the funds as tainted.”); *Byers*, 637 F. Supp. 2d at 178 (finding “some evidence that
10 commingling occurred” supported a pro rata distribution, and noting “the law does not appear to
11 require more than that”). This principle flows from the fact that money is fungible and, once
12 moneys are combined, disaggregation is somewhat arbitrary and disentanglement challenging.
13 Thus, even the “presence of some tainted funds in [a] commingled account is sufficient to taint”
14 legitimately-acquired funds in the context of money laundering. *United States v. Garcia*, 37 F.3d
15 1359, 1365-66 (9th Cir. 1994).

16 The SEC and the Receiver have introduced uncontroverted evidence that Defendants
17 generally engaged in commingling of funds affecting the investors. For example, funds were
18 regularly transferred between the Relief Defendants to cover share purchase commitments
19 obligated by other Relief Defendants. *See* Chen Decl. ¶¶ 31-47, 87-124. Eventually, all the funds
20 were combined into a single bank account. Receiver’s Mot. at 15. Moreover, funds were
21 regularly transferred in and out of the same small number of bank accounts, such that no
22 investment was ever held in a separate or exclusive bank account. Chen Decl. ¶¶ 17-19.
23 Defendants have conceded that they held funds and shares in common pools. Whether such
24 mingling was wrongful or not, these undisputed facts are sufficient for the Court to conclude that
25 investor moneys were substantially mixed together in the same bank accounts, complicating any
26 attempt to trace investor funds to determine how each investor’s money was ultimately used.

27 Further, the SEC and the Receiver have introduced uncontroverted evidence the shares
28 Defendants purchased on behalf of their investors were pooled in common holding companies.

1 Here, it is helpful to consider how the investment structure operated. Defendants “marketed
2 investments in early-to late-stage, pre-IPO technology companies, most of which are based in the
3 San Francisco Bay Area.” Compl. ¶ 2. This was accomplished through a variety of entities
4 collectively referred to as “the SRA Funds” and including Relief Defendants SRA I LLC, SRA II
5 LLC, and SRA III LLC. Each SRA fund “contain[s] several series, and each series purportedly
6 contains shares, or an economic interest in shares, in one or more particular pre-IPO companies.”
7 Compl. ¶ 24. The investors’ chief aim was “to make money on their investment from a ‘liquidity
8 event’ at one of these pre-IPO companies—either through an acquisition of that company by
9 another company or through the company’s initial public offering.” Compl. ¶ 27. Investors would
10 receive a return if the “liquidity event caused the shares to be valued at more than what the SRA
11 Funds paid for the pre-IPO interests, plus expenses.” *Id.* The SRA Funds did not purchase the
12 pre-IPO interests directly; rather, “[Defendant] Bivona purchased the pre-IPO interests on behalf
13 of the SRA Funds through [Relief Defendant] Clear Sailing.” Compl. ¶ 36. Clear Sailing then
14 continued to hold title over them. Thus, the various entities included three types of companies.
15 The “Investment Funds,” including the SRA Funds, received investor money.⁸ Ip Decl. ¶ II.1.A.
16 The “Purchasing Funds,” including Clear Sailing, purchased the shares or security interests for the
17 investors.⁹ Ip Decl. ¶ II.1.A. When shares were purchased, they were formally owned by the
18 “Purchasing Funds,” not by the “Investment Funds.” Ip Decl. ¶ IV.1. The investors did not hold
19 direct title to any of the shares; rather, they held an interest in the shares owned by the Purchasing
20 Funds, including Clear Sailing. According to the Receiver, there is no document that “track[s]
21 each investor’s capital contribution and document[s] the specific shares that were purchased with
22 those funds.” Docket No. 74, Ex. A at 5. Defendants’ records “provide no direct linkage between
23 investor capital contributions and the purchase of specific shares.” *Id.* at 6. Rather, the investors
24 only held a security interest in the shares held by the various Purchasing Funds. *Id.* at 3-4.

25
26
27 ⁸ These include the Felix Multi-Opportunity Fund I, LLC; Felix Multi-Opportunity Fund II, LLC;
28 NYPA Fund I LLC; NYPA Fund II LLC; SRA I LLC; SRA II LLC; SRA III. Ip Decl. ¶ 1.A.

⁹ These include Clear Sailing Group IV LLC, Clear Sailing Group V LLC, and Equity
Acquisition Company, Ltd. Ip Decl. ¶ 1.A.

1 Accordingly, in addition to extensive commingling of *funds*, the *shares* purchased by Defendants
2 were also pooled together, complicating any effort to meaningfully segregate or identify which
3 shares were owned by which investor at any given time.

4 d. TeleSoft's Investment Was Also Commingled

5 TeleSoft's objection does not alter the Court's conclusion. In its objection, TeleSoft
6 argues that at least \$1,022,000 of its \$1,475,500 capital investment can be tied directly to the
7 purchase of Palantir stock, and therefore should be excluded from any finding of commingling or
8 diversion of funds. TeleSoft Obj. at 4 (Docket No. 210); Gibbs Decl. ¶ 20 (total TeleSoft
9 investment); SEC's Mot. at 10; Chen Decl. ¶ 65 (Docket No. 14) (evidence of TeleSoft's
10 \$1,022,000 being wired from Clear Sailing bank account to seller of Palantir shares the same day
11 as TeleSoft's deposit). TeleSoft also argues that there is no evidence the remainder of its
12 investment was commingled with other funds or diverted to Defendants. As support, it points to
13 its contractual agreement with Clear Sailing, which represented that TeleSoft would be the sole
14 investor in a Series G, that the Series G would be used exclusively to invest in Palantir stock, and
15 that the 227,000 Palantir shares promised to TeleShare would be held in the Series G. Gibbs Decl.
16 ¶¶ 1-4.

17 TeleSoft's objection falls short for a number of reasons.

18 First, TeleSoft's reliance on its contractual agreement with Defendants, under which it was
19 purportedly the sole investor in the Series G, is insufficient to show that it was not similarly
20 situated to other investors. TeleSoft does not dispute that at all times, Defendants retained actual
21 control of all of its investment funds and of all the Palantir shares in which TeleSoft purportedly
22 held a security interest. This case is unlike cases where courts have permitted tracing because the
23 investor's assets were not within the defendant's control. *S.E.C. v. Credit Bancorp, Ltd.*, 290 F.3d
24 80 (2d Cir. 2002) (observing that in such cases, "the reason the assets were returned was not
25 merely because they were traceable, but because the assets had somehow been segregated *in the*
26 *manner of true trust accounts* and/or had *never* been placed in the defrauder's control" (emphasis
27 added)). Rather, TeleSoft's money, and the shares in which it purportedly had a security interest,
28 were maintained in virtually the same way as all other investors. *See, e.g., Byers*, 637 F.Supp.2d

1 at 180-181 (objecting investor was similarly situated to others because Defendants “exercised
2 control over the [funds]” and used the funds “as part of one overarching scheme”). Indeed, Clear
3 Sailing – not TeleSoft – held title to the actual shares in question, *see* Supp. Ip Decl., Ex. 4
4 (Docket No. 219-4) (stock certificate), just as it did for other investors, as explained above.
5 Further, these were not the first Palantir shares that Clear Sailing had purchased. *See, e.g.*, Supp.
6 Ip Decl. ¶ 7, Ex. 3; Supp. Ip Decl. ¶¶ 1-5, 7, Exs. 1, 4. The vehicle by which TeleSoft’s
7 investment was accomplished is thus not meaningfully distinguishable from other investors, as
8 explained above.

9 Second, even if TeleSoft *could* show that its funds were segregated or its shares were
10 traceable and identifiable, that, standing alone, would not be a basis for excluding it from a *pro*
11 *rata* distribution. TeleSoft does not challenge the SEC’s evidence that *other* investors’ funds were
12 commingled; TeleSoft appears to acknowledge that they were. TeleSoft Obj. at 4 (“[W]hile the
13 other fund investors may have invested in series that could potentially have commingled assets,
14 TeleSoft did not.”). Accordingly, whether or not TeleSoft’s funds were also commingled, the
15 commingling of other funds would be a sufficient basis to reject tracing even for those investors
16 who *were* able to trace their funds. *See, e.g., Sunwest Mgmt.*, 2009 U.S. Dist. LEXIS 93181 at *34
17 (“Due to the fungibility of money . . . courts have held that any commingling is enough to warrant
18 treating all of the funds as tainted.”); *Byers*, 637 F.Supp.2d at 178 (finding “some evidence that
19 commingling occurred” supported a *pro rata* distribution, and noting “the law does not appear to
20 require more than that”). *See also Commodity Futures Trading Comm’n v. Topworth Int’l, Ltd.*,
21 205 F.3d 1107 (9th Cir. 1999) (affirming *pro rata* distribution plan even though investor could
22 demonstrate ending account balance with reliable records because others could not). That is
23 precisely the situation the Fifth Circuit confronted in *Durham* and *Forex Asset*, where it affirmed
24 the district court’s refusal to permit tracing even where undisputed evidence showed that the
25 investments were either traceable or segregated. *See Durham*, 86 F.3d at 73 (tracing not permitted
26 where one investor could indisputably trace its \$70,000 investment); *Forex Asset*, 242 F.3d at 331
27 (tracing not permitted where it was undisputed that \$800,000 investment had been segregated (*i.e.*,
28 not commingled)).

1 Third, TeleSoft has failed to demonstrate that its funds were in fact segregated. TeleSoft
 2 does not contest that the bank account into which it made its \$1,475,500 investment was also used
 3 to hold money from other investors. Indeed, TeleSoft has not challenged the following:

- 4 • TeleSoft’s capital contribution of \$1,475,500 to Clear Sailing was wired to Clear
 5 Sailing’s bank account (“CSGV-VNB-0952”) on March 5, 2014. Prior to the deposit,
 6 the balance was \$426. Chen Decl. ¶ 65. As that bank account was opened on January
 7 1, 2013, it appears those funds were from other investors. Chen Decl. ¶ 17, Table 2.
 On the same day as TeleSoft’s deposit, \$1,022,000 was wired from that bank account
 8 to a seller of Palantir shares. *Id.* At the end of the day, the balance was \$453,881. *Id.*
- 9 • In the following days, \$230,000 was wired out of the account into accounts belonging
 10 to John Bivona (JBivona-VNB-0187) and Frank Mazzola (FMazzola-WFB-5073) for
 11 unknown reasons. Chen Decl. ¶¶ 66-68. John Bivona’s account had held funds for
 other investors, including for investments in Pipio Associates and Twitter. Chen Decl.
 12 ¶ 53. Mazzola’s account had also previously been used to hold money for Badgeville
 13 shares, *id.* ¶¶ 58 and 63, and for distributions to managers, *id.* ¶ 60.
- 14 • On March 21, 2014, two transfers of \$200,000 were made into the CSGV-VNB-0952
 15 account from Saddle River Advisors accounts, one of which had an unknown purpose
 16 and the other which was documented as “for purchase of stock.” Chen Decl. ¶¶ 74-75.
 17 The same day, \$75,000 was wired out to an account belonging to Frank Mazzola.
 18 Chen Decl. ¶ 76.
- 19 • On May 23, 2014, another \$250,000 was transferred from Saddle River to the CSGV-
 20 VNB-0952 bank account; the same day, \$100,000 was then wired from the CSGV-
 21 VNB-0952 account to purchase shares from a Square seller. Chen Decl. ¶ 115-116.
- 22 • On May 28, 2014, a Saddle River Advisors account transferred \$100,000 to CSGV-
 23 VNB-0952; the same day, \$250,000 was wired out of the account to purchase shares
 24 from Alibaba. Chen Decl. ¶¶ 118-119.

25 The SEC’s evidence that money was transferred between that account and accounts owned by
 26 Defendants John Bivona and Frank Mazzola is uncontested. Similarly, it is uncontested that some
 27 of the money transferred into and out of the CSGV-VNB-0952 account was used to purchase
 28 shares in several other companies (including Square, Alibaba, Badgeville, Palantir, and Pipio
 Associates). Thus, contrary to TeleSoft’s contentions, the money it gave to Clear Sailing was in
 fact mixed with money from other investors or from other bank accounts belonging to Defendants
 Bivona and Mazzola. This mixing of funds is a clear form of commingling.

Fourth, TeleSoft’s argument that it can identify the shares of Palantir which it owns is also

1 meritless. The SEC presented uncontroverted evidence that Defendants told TeleSoft that the
2 Palantir shares it had been assigned were represented by the stock certificate CSA-35; this
3 certificate, however, was purchased *two years* before TeleSoft made the \$1,475,500 investment
4 with money from *other* investors intended for shares in Facebook and Twitter, *not* Palantir. Supp.
5 Ip Decl. ¶ 7, Ex. 3; Supp. Ip Decl. ¶¶ 1-5, 7, Exs. 1, 4. The SEC also presented uncontroverted
6 evidence that a portion of TeleSoft’s money was actually used to purchase a different number of
7 Palantir shares than TeleSoft had asked for, and represented by a different stock certificate, CSA-
8 435. Supp. Ip. Decl. ¶¶ 6-7, Exs. 2, 3. Accordingly, the record shows that the shares TeleSoft
9 purportedly received were purchased with money from other investors, and that TeleSoft’s money
10 was used to purchase shares for other investors. This demonstrates clearly that not only were
11 TeleSoft’s moneys and shares both commingled, but likely that its funds, along with other
12 investors’ funds, were used in a manner inconsistent with their original purpose. *Sunwest Mgmt.*,
13 2009 U.S. Dist. LEXIS 93181 at *28-29 (evidence that defendant “decided how and where to use
14 funds on a ‘who-needs-the-cash-now’” supporting finding of commingling and consolidated, *pro*
15 *rata* distribution method).

16 In its supplemental objection, TeleSoft responds that it is not arguing it is entitled to
17 200,000 shares of Palantir because they are the same shares that were promised to it and
18 represented by the CSA-35 certificate, but rather, because TeleSoft’s investment funds can be tied
19 directly to their purchase. TeleSoft Supp. Obj. at 6, n. 2 (Docket No. 226). This argument,
20 however, is not an argument that no commingling occurred or that TeleSoft’s investment was
21 meaningfully segregated. Rather, it is a classic tracing argument. That TeleSoft is able to trace
22 how its funds were misused, or what was ultimately purchased with them, is a matter of mere luck,
23 given the state of Defendants’ records. TeleSoft has presented no compelling reason why the
24 Court should place it ahead of other investors by permitting it to trace its investment if the Court
25 were to adopt a *pro rata* distribution method. *See Wilson*, 659 F.3d at 956 (investors who can
26 trace their funds in a fraudulent scheme “do[] not necessarily move . . . ahead of all of the other
27 victims”). The conclusion that tracing would unfairly benefit TeleSoft would be bolstered if, as
28 alleged by the SEC, it is proven that by the time TeleSoft wired money to Defendants, Defendants

1 already had a shortfall of 678,527 shares of Palantir.¹⁰ Ip Decl. ¶¶ 18-21, Ex. 1; Supp Ip Decl. ¶ 7,
 2 Ex. 3. If true, it would further undermine the notion that the shares purchased with its money were
 3 TeleSoft's in any meaningful sense, since it would tend to show that the shares purchased with
 4 TeleSoft's money were intended to cover shortfalls to other, earlier investors.

5 For these reasons, the Court overrules TeleSoft's objection. It would be inequitable to
 6 permit TeleSoft to trace its investment at the expense of other investors.¹¹

7 2. Request to Exclude Relief Defendant Anne Bivona From Distribution Plan

8 The SEC and the Receiver have requested that Defendants, Relief Defendants, and other
 9 insiders be excluded from the distribution. Only Relief Defendant Anne Bivona has objected,
 10 arguing that she has a legitimate claim to repayment of a \$1.4 million loan she gave to Defendants
 11 to facilitate the purchase of shares. The remaining Defendants have disclaimed any right to file a
 12 claim with the Receiver for any amount. The Court **GRANTS** the request with respect to the non-
 13 objecting Defendants, Relief Defendants, and company insiders.

14 However, for the reasons below, the Court concludes an evidentiary hearing is required to
 15 determine whether Ms. Bivona should be excluded or otherwise treated differently from other
 16 claimants. The Court begins with whether a bona fide loan exists, then proceeds to analyze
 17 whether exclusion or other differential treatment is warranted for Ms. Bivona's claim.

18 a. Whether Ms. Bivona's Loan Was Bona Fide

19 The SEC casts doubt on whether the loan Ms. Bivona gave and for which she intends to
 20 make a claim was bona fide. Ms. Bivona purportedly gave a \$1.4 million loan to Saddle River in
 21 late 2014 "to complete a purchase of shares for the funds and their investors." Bivona Decl. ¶ 2;
 22

23 ¹⁰ As mentioned above, the objecting Investor Group challenges the notion that there is a shortfall
 24 of Palantir shares, a matter that will be reviewed at the September 28, 2017 hearing.

25 ¹¹ Global Generation Group/Benchmark have filed an objection to the proposed distribution plan,
 26 mostly for reasons that will be the subject of the September 28 hearing. However, Global
 27 Generation claims that, "[i]f the Court were to consider an allocation of Palantir shares to
 28 individual investors, such as Telesoft, Global submits it is entitled to such an allocation. Indeed,
 Global is prepared to present evidence that its purchase of Palantir shares is far more directly
 traceable than Telesoft's investment." Docket No. 227 at 2. Because the Court will not permit
 Telesoft to do so, it will not permit other investors who claim to have the ability to trace their
 funds either.

1 *see also* Bivona Response to RFP No. 3 at 4-5 (Bivona Decl., Ex. A). The loan was given at a 6%
2 per annum interest rate. Docket No. 225 at AB000060. Defendant SRA has repaid all but
3 approximately \$198,333 to Ms. Bivona with money from two of its bank accounts and an attorney
4 escrow account belonging to Mr. Bivona. Response to RFP No. 3 at 4-5 (Bivona Decl., Ex. A).
5 That the loan was evidenced by a note, interest was charged, and repayments were made are
6 factors suggesting the loan was real. *See Welch v. C.I.R.*, 204 F.3d 1228, 1230 (9th Cir. 2000)
7 (identifying factors used to analyze bona fides of a loan agreement) (citation and quotation
8 omitted). Moreover, the loan was given at a 6% per annum interest rate, a far cry from the
9 exorbitant 10% monthly interest rate loan which the court opted to treat as an investment rather
10 than a loan in *Basic Energy*. *See* 273 F.3d at 663.

11 The Court will assume that the loan was bona fide. However, the SEC may attempt to
12 present evidence to challenge the loan's bona fides at the evidentiary hearing. Even if the loan is
13 found to be bona fide, there may be grounds for excluding or discounting Ms. Bivona's claim for
14 repayment.

15 b. Legal Authority to Exclude Claimants

16 The power to exclude persons from a distribution plan is within the scope of the "district
17 court's decision relating to the choice of distribution plan for the receivership," *Quilling v. Trade*
18 *Partners, Inc.*, 572 F.3d 293, 298 (6th Cir. 2009), and the court's exercise of its discretion "in a
19 logical way to divide the money." *SEC v. Basic Energy & Affiliated Res.*, 273 F.3d 657, 670 (6th
20 Cir. 2001) (quoting *Forex Asset*, 242 F.3d at 670). *See also S.E.C. v. Enter. Trust. Co.*, 559 F.3d
21 649, 652 (7th Cir. 2009) (district court has authority "to classify claims sensibly in receivership
22 proceedings"). Thus, it is "in the district court's discretion to determine how and to whom the
23 money will be distributed." *S.E.C. v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997).

24 Other than references to broad principles of equity, however, the Court has not located
25 case-law that sets forth a minimum threshold of misconduct that a person must have engaged in to
26 justify his or her exclusion from a distribution plan. The Court can discern at least two common
27 situations justifying exclusion, however.

28 First, courts recognize that "[d]isqualifying those who took the business over the edge is

1 the most common feature, and the least contested aspect, of distribution plans.” *SEC v. Enterprise*
2 *Trust Co.*, 2008 U.S. Dist. LEXIS 79731 at *10 (N.D. Ill. Oct. 7, 2008). In *Enterprise Trust*, the
3 receiver proposed excluding two business operators who “were the principals who induced clients
4 to bring their accounts to [the business], prevented some from getting assets out of [it], engaged in
5 speculative trading that lost millions, covered up their losses and violated the laws of Illinois and
6 Nevada.” *Id.* at *9-10. The court explained that “[t]here are no hard rules governing a district
7 court’s decisions in matters like these,” and “[t]he standard is whether a distribution is equitable
8 and fair in the eyes of a reasonable judge.” *Id.* at *10. The court forbade the recovery because
9 “the primary operators” of the fraudulent scheme had “violated state laws, gave false reports to
10 clients, and performed other bad acts including the failure to cooperate meaningfully with the
11 Receiver’s investigation.” *Id.* at *17. They were not “innocent victims.” *Id.* The principle
12 discerned from these facts is that it would be inequitable to permit a person whose active
13 misconduct or unlawful activity resulted in harm to investors to recover through a distribution.
14 *See also Byers*, 637 F.Supp.2d at 184 (proposal to “treat differently those involved in the
15 fraudulent scheme when distributions are being made is eminently reasonable and is supported by
16 case law”); *Basic Energy*, 273 F.3d at 660 (affirming distribution plan that excluded defendants
17 accused of orchestrating Ponzi scheme).

18 Second, courts have approved the exclusion of individuals who had claims recovery of
19 which, by its very nature, would have resulted in the claimant profiting from the fraudulent
20 scheme, even when the claimant did not knowingly engage in unlawful, wrongful, or criminal
21 conduct. For example, in *Pension Fund*, the Eleventh Circuit affirmed the exclusion of a sales
22 agent who “had put a great deal of effort into promoting and marketing [defendant’s] products to
23 investors” and who had “received at least \$660,000 in commissions” based on his role. *See* 377
24 Fed.Appx. at 963. He had been “responsible for recruiting the investors who ultimately suffered
25 losses due to the [company’s] fraud.” *Id.* Equity required denying the claim because “it would be
26 inconsistent with the equitable distribution . . . to reduce the total potential recovery of the
27 [victims] by compensating a former [sales agent] for commissions and/or wages earned in
28 furtherance of the very fraudulent scheme that caused the losses at issue.” *Id.* There was no

1 indication that the sales agent was aware of the fraud and he was not a party to the SEC
2 enforcement action. *Id.* at 959. Thus, if the claim, by its very nature, involves a profit from the
3 fraud earned, *e.g.*, through actively inducing others to join, equity may require exclusion.

4 Thus, the cases support, at the very least, complete exclusion of active wrongdoers as well
5 as the exclusion of claims that involve a profit from the fraud.¹²

6 c. The Record Does Not Support Exclusion Under These Holdings

7 The undisputed facts in the record thus far do not establish that Ms. Bivona falls into either
8 of the two categories discussed above. Although the SEC argues that Ms. Bivona’s ownership
9 alone justifies excluding her,¹³ the SEC has not alleged that Ms. Bivona engaged in any active
10 wrongdoing or unlawful conduct, or that in making the loan she profited from the fraud. To the
11 contrary, the SEC thus far has only established that Ms. Bivona was a passive owner. Reply at 4
12 (“[I]t is undisputed that neither Anne Bivona nor Michele Mazzola worked for the businesses or
13 made any business decisions.”).

14 Accordingly, Ms. Bivona’s ownership interest, standing alone, is not similar to the role
15 played by excluded insiders or owners in *Byers*, *Enterprise Trust*, or *Pension Fund*, and is not,
16 without active wrongdoing, a basis to exclude her.¹⁴

17
18 ¹² The Court does not suggest that these are the *only* two situations in which equity may justify
19 complete exclusion. Applying general principles of equity might conceivably support exclusion in
20 other circumstances, too, *see, e.g., Enterprise Trust Co.*, 2008 U.S. Dist. LEXIS 79731 at *10
21 (considering whether a claimant was an “innocent victim”); *Byers*, 637 F.Supp.2d at 184 n. 21
22 (“The Court also has the authority to consider the culpability of any investor seeking to recover
23 under the Plan under the equitable doctrine of unclean hands.”), but the SEC has yet to make a
24 persuasive showing on any other ground.

25 ¹³ Ms. Bivona held an ownership interest in SRA Management Associates. Anne Bivona’s
26 Answer, ¶ 38, Docket No. 112 (“Admit that in approximately 2013 Anne Bivona and Michele
27 Mazzola became members of Saddle River Advisors.”). It is unclear whether she was a full owner
28 or a partial owner.

¹⁴ The SEC has also suggested that Ms. Bivona’s “purported ‘ownership’ of the defendant entities
appears to be nothing more than an attempt to shield some of their husbands’ fraudulently
obtained assets.” Reply at 4. To the extent this is based on the suggestion that Ms. Bivona should
not recover in the future because she previously received money she should not have received
(whether because she was an owner or as repayments on her loan), the SEC’s prospective
settlement with her, requiring her to repay some amount, would resolve that issue. To the extent
this is based on the suggestion that Ms. Bivona engaged in some form of active wrongdoing by

1 d. Awareness of Purpose of the Loan as Basis to Treat Claim Differently

2 The SEC contends that Ms. Bivona either knew or was “willfully blind” to the fact that the
3 loan would be used to perpetuate a fraudulent scheme. The SEC has not cited a case where a
4 claimant was excluded from recovery solely on the basis of their awareness of another’s
5 wrongdoing. Nonetheless, even in the absence of total exclusion, the Court must examine whether
6 Ms. Bivona’s claim should be treated differently or discounted – should her claim be treated as
7 repayment of a loan or as an investment subject to the distribution plan ordered by the Court?

8 Here, the Court considers *Basic Energy* to be instructive. In *Basic Energy*, after SEC
9 litigation had been initiated, a group of investors placed a sum of money in escrow on the
10 defraudor’s promise that, if the money could not be used to obtain a loan to make other investors
11 whole within thirty days, the escrow amount would be returned to them. 273 F.3d at 661-62.
12 When the receiver discovered the assets, they were seized and included in the consolidated
13 distribution plan. The escrow investors sought to have the money returned to them outside the
14 distribution plan but the district court refused, opting to treat the purported loan as an investment
15 primarily based on the high 10% monthly interest rate. *Id.* However, the court created an
16 exception for any investors who could show that they were “completely and totally innocent and
17 had no knowledge of the SEC’s litigation against [the defraudor].” *Id.* at 663. The Sixth Circuit
18 affirmed. Thus, in *Basic Energy*, the investors’ awareness that they were offering a loan to a
19 business subject to an SEC enforcement action was deemed as a factor that would justify de-
20 prioritizing their claim vis-à-vis other creditors.

21 Under these principles, a person who is aware of the possibility of wrongful or fraudulent
22 conduct may not be “completely and totally innocent.” *Id.* at 663. Knowledge can affect their
23 relief. *See, e.g., In re Tristar Esperanza Properties, LLC*, 488 B.R. 394, 402 (9th Cir. 2013)
24 (explaining that “both creditors and investors ‘accept the risk of enterprise failure’” but the risks
25 “are based on different assumptions,” because investors “expect to participate in the profits of the
26 enterprise” whereas creditors do not).

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28 willfully or intentionally “shield[ing]” her husband’s wrongdoing, this rests on unproven and
disputed state of mind issues discussed below.

1 In *Basic Energy*, the investors who knew of the pending SEC litigation (they also knew
2 they were getting exorbitant interest) when they gave their “loan” were not excluded, but their
3 claim was de-prioritized – they were treated like other investors for the balance of their loan, not
4 as loan creditors. Hence, if Ms. Bivona knew that her husband’s misconduct created a shortfall
5 that required her loan to keep it afloat, for example, but gave the loan anyway, she might not be
6 able to claim creditor status as a lender.

7 What equity requires will likely depend on the level of Ms. Bivona’s awareness. Here, the
8 SEC has suggested that Ms. Bivona was “willfully blind” to her husband’s alleged wrongdoing.
9 Traditionally, courts have treated “willful blindness” as equivalent to actual knowledge in the
10 criminal context. See *Global-Tech Appliances, Inc. v. SEB S.A.*, 563 U.S. 754, 766, 769 (2011)
11 (applying the doctrine of willful blindness to civil lawsuit for patent infringement). Cf. *U.S. v.*
12 *Heredia*, 483 F.3d 913, 918, n.4 (9th Cir. 2007) (explaining that “deliberate ignorance, otherwise
13 known as willful blindness, is categorically different from negligence or recklessness”).

14 Ms. Bivona acknowledges she knew the loan would be used “to complete a purchase of
15 shares for the funds and their investors,” Bivona Decl. ¶ 2, but she expressly denies knowledge of
16 any unlawful conduct. *Id.* ¶ 7. That she knew the loan would be used “to complete a purchase of
17 shares for the funds and their investors” is not, standing alone, sufficient to conclude that she
18 knew about the fraudulent scheme or, if she did, what level of culpability she had (willful
19 blindness, recklessness, negligence).¹⁵ Indeed, because the loan was used to purchase shares for
20 investors who had sought such purchase, it is also plausible that the loan benefited, not harmed,
21 those investors. On the other hand, the SEC contends she knew about her husband’s wrongful
22 conduct and diversion of funds.

23 Accordingly, an evidentiary hearing is required to determine Ms. Bivona’s level of
24 awareness about the fraudulent scheme when she made her loan.

25 3. Request to Terminate Management Agreements

26 The SEC and the Receiver initially requested that the Court find that Defendants’
27

28 ¹⁵ The SEC referred to deposition testimony Ms. Bivona had given, but that testimony has not
been presented to the Court.

1 misconduct would justify terminating the management and advisory agreements with them and
2 excluding them from receiving any associated management or advisory fees that may be due going
3 forward. At the hearing, Defendants' counsel confirmed that Defendants would not file a claim to
4 recover any management or advisory fees. Accordingly, the issue is moot and the Court need not
5 resolve whether their conduct would have justified barring them from doing so.

6 Whether the agreements should be terminated, however, relates more closely to the type of
7 distribution plan ultimately adopted by the Court. Accordingly, the Court will defer its decision
8 until it has had the opportunity to consider the evidence and arguments of the parties and objectors
9 regarding the proposed distribution plans. The Court advises, however, that if any of Defendants
10 or other alleged insiders are proposed under any plan to manage any of the assets going forward,
11 the Court will deem it necessary to examine their past conduct or role, if any, in the fraudulent
12 scheme alleged in this case. The Court is unlikely to approve appointment of a manager
13 implicated in prior misconduct. Thus, the parties and the objectors are advised that, if such
14 persons are contemplated for management positions going forward, they should be prepared to
15 present and argue whether entrusting such a person with management of the funds going forward
16 would be fair, reasonable, or equitable.

17 **III. CONCLUSION**

18 The SEC and Receiver's request for preliminary findings is **GRANTED IN PART** and
19 **DENIED IN PART**. For the reasons herein stated, the Court finds that Defendants commingled
20 investor funds and shares, in that investor funds were held in common accounts and shares were
21 held by common entities; investor funds thus generally are not segregable or traceable. The Court
22 **OVERRULES** TeleSoft's objection to this finding. The Court **DECLINES** to make a finding at
23 this time related to whether Defendants otherwise violated the securities laws, including whether
24 the commingling was improper or whether they unlawfully diverted funds. Such a finding is not
25 required to determine whether a *pro rata* distribution would be equitable.

26 The SEC and the Receiver's request to exclude non-objecting Defendants, Relief
27 Defendants, and insiders from the recovery is **GRANTED**. However, the Court concludes that an
28 evidentiary hearing is needed to resolve disputed factual issues regarding whether an equitable

1 basis exists to exclude Anne Bivona from recovering the balance of her loan (if bona fide) or
2 otherwise treat the claim differently pursuant to a distribution plan. The parties must submit a
3 proposal for the evidentiary hearing process by **September 26, 2017**.

4 Finally, the Court at this time reserves the issue of whether the management and advisory
5 agreements should be terminated until it has reviewed the parties' proposed distribution plans. As
6 noted above, however, the request to bar Defendants from recovering fees under those agreements
7 is **GRANTED**.

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9 **IT IS SO ORDERED.**

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11 Dated: September 13, 2017

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14 EDWARD M. CHEN
15 United States District Judge
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