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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

JOHN V. BIVONA; SADDLE RIVER ADVISORS, LLC; SRA MANAGEMENT ASSOCIATES, 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

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S BRIEF IN SUPPORT OF ITS PROPOSED AMENDMENTS TO JOINT DISTRIBUTION PLAN

Date: April 5, 2018
Time: 1:30 p.m.
Courtroom: 5
Judge: Edward M. Chen

SUMMARY OF POSITION

Plaintiff Securities and Exchange Commission ("Commission") hereby submits its Brief in support of its Proposed Amendments to the Joint Distribution Plan, and to explain the basis for its position as requested in the Court's February 9, 2018 Minute Order ("Order") (ECF 309). Under separate cover, the Commission is also submitting its Proposed Amendments to the Joint Distribution Plan.

In preparing these submissions, the Commission arranged two conference calls with counsel for the Receiver, the SRA Investor Group ("Investor Group") and Global Generation, LLC to discuss the Court's Order and to describe the Commission's position. The conference calls proved useful in clarifying each party's position and in reaching agreement on particular issues. The process also helped delineate the basic difference in the positions between the Commission and the Receiver, on the one hand, and the Investor Group, on the other hand. In short, the Commission and the Receiver believe the most fair and reasonable plan under the circumstances of this case require the use of a consolidated pool for *pro rata* payments to the receivership entities' investors. The Investor Group indicated that they do not believe any such *pro rata* structure is appropriate, relying instead on the ultimate success or failure of each pre-IPO company to determine the investors' ultimate recoveries. Below, the Commission addresses, first, the four enumerated, outstanding issues that the Court requested in its Order that the parties specifically address. Then, in the second section, the Commission more fully describes its amendments to the Distribution Plan jointly proposed with the Receiver.

I. THE COMMISSION'S POSITION ON OUTSTANDING ISSUES IDENTIFIED BY THE COURT

1. *The Commission's Proposed Method For Valuing Pre-IPO Investor Claims*

As previously briefed, the Commission supports in this case the *pro rata* distribution to investors and creditors from the proceeds of a consolidated pool of the pre-IPO interests held by Clear Sailing Group IV, LLC and Clear Sailing Group V, LLC ("Clear Sailing") for the receivership investment funds – i.e., Felix Multi-Opportunity Funds I and II, LLC ("FMOF I and II"), NYPA Funds I and II, LLC ("NYPA I and II") and SRA I, II and III, LLC ("SRA Funds"). The

Commission's position in this case is consistent with the case law in other equitable receivership cases. *See SEC v. Sunwest Management*, 2009 U.S. Dist. LEXIS 93181 at *34 (D. Or. 2009) (authorizing consolidated *pro rata* investor recoveries from a pool of real estate holdings); *SEC. v. Byers*, 637 F. Supp. 2d 166, 178 (S.D.N.Y. 2009) (authorizing consolidated *pro rata* investor recoveries from a combined pool of real estate portfolios). Using a consolidated pool of assets is appropriate to repay investors in Ponzi-scheme frauds. *SEC v. Byers*, 637 F. Supp. 2d at 177 (citing *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 89 (2d Cir. 2002)). *Pro rata* distribution is particularly appropriate where it is difficult to trace investor funds to particular assets and where the recordkeeping is inconsistent, inaccurate, or changed after the fact. *SEC v. Sunwest Management*, 2009 U.S. Dist. LEXIS 93181 at * 28-29.

It's the Commission's position that investor claims should be calculated by using the investor's out-of-pocket investment in a pre-IPO company through one of the receivership entities, minus any actual distributions to the investor for that pre-IPO company. Prior to the appointment of the Receiver on October 11, 2016, investors received distributions of securities (and proceeds from sales of securities) for companies that had experienced liquidity events, such as the IPOs of Twitter, Inc. and Facebook, Inc. Those previously-distributed securities are therefore not included in the Plan.

In the Commission's discussions with the Investor Group, they did not propose a methodology for currently valuing investor holdings. Instead, the Investor Group would suggest relying entirely upon future events to dictate the value of each investor's pre-IPO holdings. Thus, if a company were to fail in the future, the investor would receive no return on his or her shares in that company. And, if a company were to have a liquidity event at some point in the future, the investor's return would be determined by the market price of his or her shares and/or any distribution by the company to its shareholders. This approach requires a "wait and see," and ties each investor's ultimate recovery to the company in which they intended to invest, thereby disregarding the fact that the investors' share allocations might never have been purchased or, if purchased, might have been obtained with money from other investors. In other words, the Investor Group disregards the Court's previous finding that the defendants engaged in extensive commingling through the receivership entities, such that tracing investor money to their intended share purchases might not be feasible.

Order Regarding Plaintiff SEC and Receiver's Request for Preliminary Findings Related to Proposed Joint Distribution Plan, dated September 13, 2017, at 15-18 (ECF 246).

The Commission, in contrast, considers it critical that the Distribution Plan ultimately adopted by the Court not overlook this very basic fact. Because this receivership arises from the commingling of receivership assets and the diversion of investor money to other purposes in a Ponzi-like fashion, a specific investor's money cannot always be traced to the purchase of pre-IPO shares in the investor's intended pre-IPO company. Accordingly, it would be unfair under these circumstances to purport to conduct a tracing that would pit investors against each other. *See United States v. Wilson*, 659 F.3d 947, 956 (9th Cir. 2011) (writing that "courts generally will not indulge in tracing when doing so would allow one fraud victim to recover all of his losses at the expense of other victims").

The Plan's Treatment of Other Creditor Claimants

In addition to investors in pre-IPO shares, there are other persons who will make, or have made, claims against the receivership estate. In 2011, a non-receivership entity, FB Management, LLC, held about $4 million in investment proceeds that belonged to Progresso Ventures. FB Management purportedly "lent" that $4 million to receivership entity, FMOF Management, which then used the funds to purchase Palantir shares for the FMOF investment funds in November 2011. Only a portion of the $4 million was repaid by FB Management to Progresso Ventures, which has submitted a claim for the unpaid balance, plus a contractual rate of interest and attorneys' fees and costs to pursue a collection action in New York state court. Because its money was used by FMOF to purchase Palantir shares, the Amended Plan would allow Progresso Ventures to receive an unsecured claim for the still unpaid principal amount.

There are other creditor claimants who lent money to, or were promised payment by, one of the receivership management entities – i.e., FMOF Management, NYPA Management, or SRA Management. These claims involve creditors who are seeking a recovery against future, contingent, fees under management contracts that should be terminated. In particular, in 2016, Pradeep Sindhu obtained a $4 million confession of judgment against FMOF Management, NYPA Management and SRA Management for repayment of a loan that Mr. Sindhu made several years earlier to FB Management. Additionally, there are claims totaling about $500,000 by persons who invested in 7%

interest notes issued the Saddle River Profit Opportunity, LLC. These notes were to be repaid from back-end fees that might be collected by FMOF Management, NYPA Management and SRA Management from a liquidity event for the Palantir shares. In addition, according to the Affidavit that John Bivona provided to the Receiver in October 2016, there are brokers who were promised 50% of the backend fees collected by FMOF Management, NYPA Management and SRA Management. The Commission has proposed in the Amended Plan to subordinate these types of management fee creditor claims until the investors recover the principal amount of their investments with interest. Further, the Commission and the Receiver have proposed terminating the management contracts with FMOF Management, NYPA Management and SRA Management.[1]

Finally, another person has a $300,000 confession of judgment claim against SRA Management based upon a purported guarantee of that person's investment in pre-IPO shares. Because that guarantee gives the investor an unfair preference over other investors, the Amended Plan would provide that investor with the same *pro rata* recovery available to other investors.

2. *How the Commission Proposes Handling Receivership Claimants Who Thought They Invested in Failed Companies*

Where investor money has been commingled and/or diverted, the equities require that "all victims of the fraud be treated equally." *See United States v. Real Property Located at 13328 and 13324 State Highway 75 North*, 89 F.3d 551, 553 (9th Cir. 1996) (citing *Cunningham v. Brown*, 265 U.S. 1, 12-13 (1924)). Thus, the Commission proposes in its Amended Plan that all investors should therefore have the opportunity to recover under any distribution plan. *See Id.* at 553-54 (approving plan to have all investors recover from sale of real property that was purchased with money from a particular investor). This principle is critical to ensuring recovery to investors who thought they were investing in companies that failed before the receivership, but whose investment funds were actually used to purchase shares in other pre-IPO companies.

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[1] Sindhu's claim may also be subject to challenge as a fraudulent conveyance because FMOF Management, NYPA Management and SRA Management did not receive any value for guaranteeing FB Management's prior debt.

Thus, the Commission proposes that under the Amended Plan, an investor who intended to invest in companies which all ultimately failed may nonetheless seek a 25% to 30% recovery on the face amount of his or her failed investment(s), even if one or more of the investments failed before this receivership began. The amount of the recovery will depend upon the total amount of these types of claims and the assets available to pay such claims.

The Commission proposes, for example, that an investor who intended to purchase only shares of Jumio, Inc., which went bankrupt before the receivership began, would receive a 25% to 30% recovery so long as the investor is not holding claims to shares in another, active, investment such as Addepar, Inc. or Palantir Technologies, Inc. The Commission estimates that at the current time, the combined principal amount of investors in only failed companies is about $200,000, so that a hypothetical 25% recovery would total approximately $50,000. In the Commission's discussions with the Investor Group, they indicated that they were open to such a small recovery for the purely practical reason of avoiding disputes over a small dollar amount.

3. ***Partial Portfolio Sales Are Feasible to Repay Investors Before Liquidity Events***

From the parties' discussions with the investment banker, Marc Winthrop, the Commission understands that is may be feasible to sell a portion of the receivership's Portfolio to secondary market investors if the sale is structured appropriately. Mr. Winthrop recommends soliciting offers to purchase shares at a particular price for the portion being offered. Mr. Winthrop has provided a fee proposal for such sales that would be acceptable to the Commission.

To this point, the Investor Group has not been willing to support Mr. Winthrop's retention for the next phase of the receivership because the Investor Group considers an investment banker unnecessary. The Investor Group favors simply waiting until liquidity events provide some valuation for the shares of a pre-IPO company or an adverse event, such as a bankruptcy filing, renders the shares of a pre-IPO company worthless. To the extent that some investors might desire an early redemption of their interests, the Investor Group favors finding other investors who would be willing to purchase the interests in private transactions. The Commission believes that such private transactions would be risky because the transactions would lack the assurances of court review, fair prices, or compliance with the securities laws.

The Commission proposes using an investment banker, as it is prudent not to rely solely on the "wait and see" approach that the Investor Group advocates. An investment banker should be retained to solicit firm bids for some of the receivership Portfolio and to monitor potentially advantageous opportunities to sell pre-IPO shares in the secondary market, rather than waiting for a liquidity event. Additionally, if some investors or creditors elect an early redemption of their interests, the investment banker could determine whether it would be feasible to sell pre-IPO shares to finance that redemption. The Commission in particular advocates selling shares to finance an early redemption in a manner subject to court approval to assure an independent, fair and transparent process. An investment banker should be retained in this case, rather than relying on the wait and see approach which would give effect to the Ponzi-like scheme.

4. *The Commission's Proposal to Compensate Potential "Opt-Out" Investors*

The Commission advances in the Amended Plan a mechanism to allow investors who have submitted a valid claim to the Receiver, but do not want to wait two or more years for a distribution, to "opt out" and request an earlier distribution. The Commission proposes a distribution in an amount equivalent to 25% to 30% of the net principal amount of their investments.[2] Mr. Winthrop would be authorized to solicit sales for a portion of the receivership Portfolio to cover the requested distribution amount for these opt-out investors. If the amount raised were not sufficient to cover the requested distribution amount, the investors and certain unsecured creditors will receive a *pro rata* share of the available money, and the remaining balance of the requested distribution amount would carry over to the next distribution. If the available amount exceeds the requested distribution amount, the excess amount will be available for the next distribution to all receivership investors and certain unsecured creditors.

II. PROPOSED AMENDMENTS TO JOINT DISTRIBUTION PLAN

The Commission and the Receiver have agreed upon proposed changes to their Joint Distribution Plan. A copy of the Amended Joint Distribution Plan is attached as Exhibit A. A black-

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[2] Unsecured creditors whose claims are not subordinated or treated separately under the Amended Plan may also request an early *pro rata* distribution on 25% to 30% of the remaining principal amount of their claims.

lined version of the Joint Distribution Plan to show changed language is attached as Exhibit B. Below, we summarize the reasons for the main changes.

As with the original Proposed Joint Distribution Plan, this Amended Plan provides for the *pro rata* distribution of assets to investors and creditors based on valid claims submitted to the Receiver. The Amended Plan provides for the orderly sale of the shares and financial interests held by the receivership entities, which could involve holding the pre-IPO shares and financial interests for a period of time to maximize value.

If the Court authorizes holding the receivership's portfolio of pre-IPO shares and financial interests for a period exceeding two years, the Amended Plan provides that the Court will also create a mechanism for investors and certain creditors to elect an early payment at 25% to 30% of the claim amount (depending upon the amount of such claims and the money available to pay such claims). An early payment is not guaranteed, and will only be made if feasible after consultation with a retained financial professional and final court approval of the amounts and payees. *See* Amended Proposed Plan at 14-15 (describing early claim process).

The *pro rata* distribution of the proceeds to investors and creditors is based upon the net out-of-pocket investments for investors and the debt owed for creditors. If there are sufficient sales proceeds, investors will receive interest on the principal amount of their investments to compensate investors for the time value of their money and creditors will receive the contractual rate of interest (for creditors that are lending institutions); the treasury rate for unpaid federal funds; or such other appropriate rate as determined by the Receiver and the Court.

In the event that certain investments have no value, those investors with only worthless investments, will be entitled to submit a claim, at a discount, for a *pro rata* distribution of proceeds. These investors may submit a claim for 25% to 30% of the principal amount of their investment, and then receive a *pro rata* distribution from available assets for their discounted claim. *See* Amended Proposed Plan at 9 (describing "Rescission Claimant" and "Rescission Claim").

In the event that the sale of shares or financial interests in a particular company, generates an excess recovery and the other investors have received the principal amount of their claims plus interest, then the Receiver may propose a supplemental distribution to those investors who subscribed

and/or invested in the shares of the particular company or contracts for shares of the particular company generating the excess recovery. In addition, if investors or creditors elected an early payment and the early payment was made, the Receiver may propose a supplemental distribution to those investors and creditors on their deficiency claims.

As with the original Proposed Joint Plan, the Amended Plan disallows claims of insiders and any claims made on behalf of insiders. It also terminates management agreements, and disallows claims for management fees and advisory fees. Claims of related parties, for guarantees, for a percentage of back end fees, or for transactions that lacked adequate consideration or value will be subordinated. Such subordinated claims would be considered only at the time that claims for supplemental distributions are considered by the Court.

Dated: March 15, 2018

Respectfully submitted,

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