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Attorneys for Interested Party
Progresso Ventures, LLC

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

INTERESTED PARTY PROGRESSO VENTURES, LLC'S RESPONSES AND OBJECTIONS TO COMPETING DISTRIBUTION PLANS

Date: October 23, 2018
Time: 1:30 pm
Courtroom: 5
Judge: Edward M. Chen

RESPONSES AND OBJECTIONS TO COMPETING DISTRIBUTION PLANS

Interested party Progresso Ventures, LLC ("Progresso") hereby submits its responses and objections to the Amended Proposed Joint Plan of Distribution of the Securities and Exchange Commission ("SEC") and the court-appointed receiver ("Receiver") ("Proposed Joint Plan") and to the Proposed Alternative Distribution Plan of the SRA Funds Investor Group ("Alternative Distribution Plan"), as exchanged among the parties on August 30, 2018.[1]

I. Executive Summary

Progresso is one of the first in a long line of entities and individuals that fell victim to the Ponzi scheme perpetrated by the Defendants. Indeed, absent the Defendants' fraud against Progresso, this receivership would not hold any (or would hold far fewer) pre-IPO shares in Palantir Technologies, which are highly valued by the claimants. This Court determined in its July 30, 2018 Order that Progresso "may recover only as a money judgment creditor." Order (D.E. 385) at p. 17. As a result, because creditor claims usually are prioritized in bankruptcy and receivership proceedings alike, Progresso should receive priority treatment. *See CFTC v. Lake Shore Asset Mgmt. Ltd.*, 646 F.3d 401, 407 (7th Cir. 2011). Although there is no principled reason to depart from this general principle, the competing plans do not prioritize creditor claims over investor claims. Moreover, Progresso sought to be treated as an investor, but that application was denied. Having been denied the right to participate in any gains as an investor, certainly Progresso's treatment as a creditor ought to come with the one benefit creditors have over equity interest holders – priority. Therefore, Progresso objects to both plans on this basis.

Likewise, it is well-settled that the full faith and credit clause of the United States Constitution requires federal courts to enforce judgments entered by state courts. Nevertheless, as drafted, the Proposed Joint Plan proposes to disregard portions of Progresso's judgment, and enforce only those portions the SEC and Receiver believe should be given recognition. That is, the Proposed Joint Plan

[1] Progresso's submission addresses the competing distribution plans, as exchanged among the parties on August 30, 2018. *See* Declaration of Karen Sebaski ("Sebaski Decl."), Ex. A (Proposed Joint Plan) and Ex. B (Alternative Distribution Plan). Progresso reserves the right to amend or supplement these responses and objections to the extent that the Amended Distribution Plans filed with the Court on September 28, 2018 are materially different from the plans as exchanged on August 30, 2018.

proposes to "subordinate" certain portions of Progresso's judgment, a concept not supported by any authority. And not only does the Proposed Joint Plan *not* give full faith and credit to Progresso's entire judgment, but even as to the portions sought to be subordinated, it does not require payment of such portions at all, even if enough money is collected sufficient to pay Progresso's full judgment. As a result, the Proposed Joint Plan all but eliminates 70 percent of Progresso's claim.

For these reasons, Progresso cannot support the Proposed Joint Plan in its current form. As an alternative, Progresso respectfully submits "Redline A." Sebaski Decl., Ex. C (Redline A). Redline A makes modest revisions to the Proposed Joint Plan to prioritize creditor claims and to ensure that claims based on prior court judgments receive full faith and credit in this Court. With these important amendments, Progresso would fully support the Proposed Joint Plan.

The Alternative Distribution Plan proposed by the SRA Investor Group is vastly different from the Proposed Joint Plan. Although the Alternative Distribution Plan appears to preserve the full faith and credit of Progresso's judgment (and that of other creditors, to the extent applicable), it proposes "to replace the Receiver and substitute new management" that, unlike the Receiver, would not function as an officer of this Court. Sebaski Decl., Ex. B (Alternative Distribution Plan) at p. 2 & n.3. Rather, the SRA Investor Group "proposes to have new management assume control of the SRA Funds," with Joshua Cilano—a long-time associate of defendants John Bivona and Frank Mazzola—playing a central role. *Id.* Dissolving the receivership at this stage of the proceedings is a significant risk, and one that is highly suspect. Tellingly, counsel for the SRA Investor Group has indicated during the meet-and-confer process that it would not be content to simply replace the current Receiver. Also worrisome is that, unlike the Proposed Joint Plan, the SRA Investor Group's plan does not automatically disallow claims by former agents or employees of Fortuna Fund Management or "other insiders," with the exception of Emilio DiSanluciano. *Id.* In light of Mr. Cilano's background, such distinctions should not be overlooked.

II. Responses and Objections to the Proposed Joint Plan

As drafted, the Proposed Joint Plan is contrary to general equitable principles of insolvency law and to the well-established rule that state court judgments like Progresso's are entitled to full faith and credit—both in federal courts generally as well as in equitable receivership proceedings.

As an initial matter, general equitable principles of insolvency law recognize that creditors like Progresso should be given priority over investors. *See, e.g.*, *CFTC*, 646 F.3d at 407 ("[C]reditors are usually paid ahead of shareholders in insolvency proceedings, whether the proceedings take the form of bankruptcy, or of receivership.") (citations omitted); *see also* Progresso Supp. Br. (D.E. 384) at pp. 1-2. The Proposed Joint Plan, however, purports to place investors and creditors on equal footing.[2] As explained in Progresso's supplemental brief, the prioritization of creditors over investors is fair, because it reflects the risk each class of claimants assumed: "Because lenders and depositors do not have the chance of reaping profits should the corporation do well, corporate dissolution law shifts the risk of failure as much as possible to the stockholders." *Gaff v. Fed. Deposit Ins. Corp.*, 919 F.2d 384, 392 (6th Cir. 1990); *see also SEC v. Wealth Mgmt. LLC*, 2009 WL 10699977, at *2 (E.D. Wis. Nov. 20, 2009) ("The rule that creditors are given absolute priority over investors or equity holders is well established.").

Thus, Courts exercising their equitable powers to set priority in receiverships look to, among other things, the risk that different classes of claimants assumed when supplying money. *See, e.g.*, *SEC v. Enter. Tr. Co.*, 559 F.3d 649, 652 (7th Cir. 2009) (prioritizing one class of claimants over another in receivership, in light of risk assumed). Here, the Court has ruled that Progresso shall be treated as a creditor, and that it cannot reap the benefits investors may realize by way of larger gains. Because it is not being treated as an investor, and thus cannot participate in gains, necessarily it means Progresso should not be subject to the same risk as the SRA investors. In other words, Progresso's creditor status means, effectively, that it loaned $4 million to FB Management, and lenders get priority

[2] As detailed below, the Proposed Joint Plan as drafted disfavors judgment creditors, who are not entitled to receive the contractual interest portions of their respective judgments in any Second Distribution. By contrast, contractual interest would be paid in full to "trade and financial institutional lenders." Sebaski Decl., Ex. A (Proposed Joint Plan) at p. 9. To date, no legal authority has been cited in support of this specific distinction.

over equity holders. *SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 333 n.6 (7th Cir. 2010) (approving "receiver's plan [that] provided that distributions will be made to . . . creditors (all of whom are secured) before its investors").

Moreover, "[w]hen called upon to determine the rights of different classes of creditors . . ., a court of equity, even in the absence of statutory provisions expressly directing the order in which debts shall be ranked, will adopt and follow wherever practicable the rule prescribed by statute relating to the allowance of debts in insolvency or bankruptcy." Clark on Receivers § 860 (1918). Thus, federal receivership courts routinely look to the U.S. Bankruptcy Code for guidance. *SEC v. Total Wealth Mgmt., Inc.*, 2018 WL 3456007, at *5 (S.D. Cal. July 18, 2018) (collecting cases). The Code's priority scheme, in turn, "serves to effectuate one of the general principles of corporate and bankruptcy law: that creditors are entitled to be paid ahead of shareholders in the distribution of corporate assets." *In re Am. Wagering, Inc.*, 493 F.3d 1067, 1071 (9th Cir. 2007). Under that scheme, Progresso would be given priority. 11 U.S.C. § 510(b); *see, e.g.*, *In re Am. Wagering, Inc.*, 493 F.3d at 1071. It should be treated no worse in receivership. *See generally* Progresso Supp. Br. (D.E. 384) at pp. 1-2.

Likewise, under the full faith and credit clause of the United States Constitution, this Court is "bound to recognize the New York state court's judgment." *See* Order (D.E. 385) at pp.13-14 & n.7. Full faith and credit applies to judgment claims in receivership. *See, e.g.*, Restatement (Second) of Conflict of Laws § 417 (1971); Wright & Miller, Fed. Prac. & Proc. § 4469 (2d ed.) (federal courts must give full faith and credit to state-court judgments). The Supreme Court has thus squarely rejected attempts by receivers to impair state court judgments submitted as claims, even when those judgments post-date the receiver's appointment, holding that "the nature and amount" of a claim on a judgment is "conclusively determined" by the judgment itself. *Morris v. Jones*, 329 U.S. 545, 551, 554 (1947). Bankruptcy courts also are required to afford full faith and credit to state court judgments, including for any fees and interest components. *See, e.g.*, *In Re CWS Enters., Inc.*, 870 F.3d 1106, 1119 (9th Cir. 2017) (holding that "[t]he Full Faith and Credit Act applies" in bankruptcy courts and upholding attorneys' fee award in a judgment); *In re Ferrara*, 510 F. App'x 575, 575-76 (9th Cir. 2013) (upholding a claim for an attorneys' fee award contained in a state court judgment because the

bankruptcy court was bound by the preclusive effect of that judgment); *In re Frontier Props., Inc.*, 979 F.2d 1358, 1366-68 (9th Cir. 1992) (administrative priority given to interest award included in a state court judgment).

The rule protecting Progresso's judgment from impairment is fairly applied here. Tellingly, to date, the papers submitted by the SEC do not include a single case in which a receivership (or bankruptcy) court determined that a prior judgment was not entitled to full faith and credit. In *SEC v. Veros Farm Loan Holding, LLC*, 2017 WL 634152 (S.D. Ind. Feb. 16, 2017), the court approved of a distribution plan in which in which interest paid to investors in connection with specific offerings was applied to (and therefore reduced) amounts owed for repayment of principal. *Id.* at *3. Notably, however, *Veros* did not involve a judgment entitled to full faith and credit. Moreover, to date Progresso has not collected any part of its judgment. *SEC v. Amerindo Invest. Advisors*, Inc., 2014 WL 2112032 (S.D.N.Y. May 6, 2014) also does not address full faith and credit.

Nevertheless, the Proposed Joint Plan eviscerates full faith and credit by defining "Subordinated Claim"—a category otherwise reserved for "transactions that lacked adequate consideration" and the like—to include the contractual "interest . . . attorney's fees and costs" portions of Progresso's money judgment. Sebaski Decl., Ex. A (Proposed Joint Plan) at p. 9. As a result, contrary to full faith and credit, under this draft plan Progresso would not get credit for roughly 70 percent of its claim in any First or Second Distribution.

To make matters worse, unlike money judgment creditors, holders of "Unsecured Creditor Claims for loans or business debt" *are* entitled to their "principal amount owed ***plus contractual rate of interest***." Sebaski Decl., Ex. A (Proposed Joint Plan) at p. 13 (emphasis added). In other words, not only does the Proposed Joint Plan eviscerate full faith and credit by all but eliminating the contractual interest, attorney's fees and costs portions of money judgment claims, but the Proposed Joint Plan also does not place such claims on equal footing with Unsecured Creditor Claims generally. There simply is no principled rationale for prioritizing interest owed by contract to "trade and financial institutional lenders" while subordinating the interest component of Progresso's claim, which is *both* owed by contract and also is encompassed by a prior judgment.

Moreover, if the receivership has sufficient proceeds to make a Third Distribution (*e.g.*, in the

case of a successful IPO by Palantir), then there is no requirement that subordinated portions of money judgments be paid—let alone a requirement that such amounts be prioritized over payments to "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." Sebaski Decl., Ex. A (Proposed Joint Plan) at p. 2.

As set forth in Redline A, Progresso proposes to remedy these deficiencies by prioritizing all Unsecured Creditor Claims and excluding claims by money judgment creditors from the definition of Subordinated Claims. With these key amendments, Progresso would favor the Proposed Joint Plan.

III. Responses and Objections to the Proposed Alternative Distribution Plan

Although the plan proposed by the SRA Investor Group appears to afford full faith and credit to claims based on prior money judgments, as drafted it too does not prioritize creditor claims. Under the Proposed Alternative Distribution Plan, specific categories of funds are, in part, set aside for creditor claims (*e.g.*., cash funds currently held by the Receivership Estate, management fees, back-end fees, and any share surpluses). Nevertheless, creditor claims are not required to be paid in full before any investor in a portfolio company that has experienced a liquidity event receives their allocation of shares. *See* Sebaski Decl., Ex. B (Alternative Distribution Plan) at p. 7. For the above-discussed reasons, as drafted, Progresso also objects to the Proposed Alternative Distribution Plan on this basis.

Progresso, however, has grave concerns with two central components of the SRA Investor Group's plan—concerns that cannot be remedied by a straightforward redline. First, the Alternative Distribution Plan proposes "to replace the Receiver and substitute new management." Unlike a court-appointed receiver, which is required "to follow traditional equity practice or local rules (where they exist) for administrative matters like the procedure for disposing of or distributing assets," such new management would not function as an officer of this Court. Steven S. Gensler, 2 Federal Rules of Civil Procedure, Rules and Commentary Rule 66; *see also, e.g.*, *Great W. Mining & Mfg. Co. v. Harris*, 198 U.S. 561, 574 (1905) (explaining that "a receiver is an officer of the court which appoints him"). Dissolving the receivership at this stage of the proceedings is a significant risk. Nevertheless, during the meet-and-confer process, the SRA Investor Group indicated that it would not be content

to simply replace the current Receiver. Rather, the SRA Investor Group proposes "to have new management assume control of the SRA Funds," with Joshua Cilano—a long-time associate of defendants John Bivona and Frank Mazzola—playing a central role. Sebaski Decl., Ex. B (Alternative Distribution Plan) at p. 2.

Specifically, under the Alternative Distribution Plan, Investor Rights, LLC would "serve as the operational manager for the SRA Funds on a day-to-day basis, subject to oversight by the oversight officer." *Id.* at p. 3. The "managing member of Investor Rights, LLC is Joshua Cilano." *Id.* at p. 4. Progresso understands that Mr. Cilano is a "long-time business associate of John Bivona and Frank Mazzola" who "raised the second largest amounts of investor money in the [SRA] funds, after John Bivona" and therefore is fairly characterized as an "insider." SEC Reply I/S/O Joint Distribution Motion (D.E. 238) at pp. 1-3. In light of this association, not to mention the concerns as to "whether he is able to manage his own financial affairs responsibly," *id.* at 3, Progresso strenuously objects to any active role by Mr. Cilano (or Investor Rights, LLC) absent an evidentiary hearing to carefully evaluate Mr. Cilano's prior associations and conduct. Indeed, as the oversight officer proposed by the SRA Investor Group appears to specialize in matters involving real property, it is reasonably likely that Mr. Cilano would have significant decision-making authority under the Alternative Distribution Plan. *See* https://www.ueckerassoc.com/professionals/susan-uecker.[3]

Finally, unlike the Proposed Joint Plan, the SRA Investor Group's plan would not automatically disallow claims by former agents or employees of Fortuna Fund Management. According to the complaint filed by the SEC in this action, as of March 2016 defendant Bivona was "currently generating additional cash by soliciting money for a supposedly new investment vehicle, the Fortuna Fund. But this 'new' fund [was] run by the same Saddle River employees, and Fortuna Fund investment money has recently been diverted to cover SRA Fund expenses." Complaint ¶ 6.

[3] Although the advisory committee proposed by the SRA Investor Group that is available to assist the oversight officer and operational manager would "have no formal decision-making authority," certain proposed members also may be subject to conflicts of interest. *See* SEC Reply I/S/O Joint Distribution Motion (D.E. 238) at pp. 2-3 (stating that Peter Healy "has been in business with Cilano since 2015" and "took a significant ownership stake (20%) in" Mr. Cilano's separate advisory business, Capital Truth Holdings); *id.* at 3 (stating that Robert Brunner also was listed as an "advisory board member" of Mr. Cilano's separate advisory business).

Therefore, claims by former agents and employees of Fortuna fairly are subject to disallowance. Likewise, with the exception of Emilio DiSanluciano, the Alternative Distribution Plan also does not automatically disallow claims by all other "insiders." In light of the extensive nature of the defendants' Ponzi scheme, all insider-based claims should be automatically disallowed.

IV. Conclusion

For the reasons stated herein, Progresso objects to the Alternative Distribution Plan. As drafted, Progresso also does not support the Proposed Joint Plan, which does not prioritize creditor claims or adhere to well-established principles of fair faith and credit. Progresso therefore respectfully submits Redline A. With these straightforward amendments, Progresso would fully support this Court's adoption of the Proposed Joint Plan submitted by the SEC and the Receiver.

Dated: September 28, 2018

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