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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

RECEIVER'S REPLY TO THE SRA FUNDS INVESTOR GROUP'S RESPONSE TO THE RECEIVER'S SUPPLEMENT TO MOTION FOR INSTRUCTIONS RE TAX MATTERS RE DISTRIBUTION PLAN

Hearing Date: January 30, 2020
Time: 1:30 p.m.
Location: Courtroom 5, 17th Floor
450 Golden Gate Ave.
San Francisco, CA 94102

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Kathy Bazoian Phelps, the successor receiver herein (the "Receiver"), hereby files this Reply to the Response of the SRA Funds Investor Group (the "Investor Group") to the Receiver's Supplement to her original Motion to (1) Employ Miller Kaplan as Tax Advisors; (2) Employ Schinner & Shain as Securities Counsel; and (3) for Instructions [Doc No. 516].

I. INTRODUCTION

A distribution plan has not yet been approved in this case, despite substantial briefing and analysis. For more than two years, the parties and the Court have wrestled with competing concepts for distribution. Complexities in this case have caused approval of a plan to be elusive, and new questions, issues and hurdles are raised at every turn. Since the Receiver's appointment on February 28, 2019, the Receiver identified tax consequences that had not previously been considered. This reality inevitably introduces a new layer of complexity. As part of her fiduciary duties, the Receiver is required to address the tax consequences of the plan that the Investor Group proposed and that the Court was inclined to adopt at the time of the Receiver's appointment. As set forth in her Supplement, the Receiver engaged in thoughtful analysis of all apparent tax mitigation strategies and detailed analysis of applicable law, yet the Investor Group challenges the Receiver's conclusions without providing any contrary authority. While it is understandable that the Investor Group does not want the estate to pay taxes, that desire alone, without any legal or factual support, cannot formulate the basis of a distribution plan.

The unsupported position of the Investor Group highlights other significant concerns with the Investor Group plan that have crystalized with this dispute about tax treatment. The current plans contemplate holding on to Pre-IPO Shares until they go public or have a liquidity event and then returning the publicly traded shares to investors. The 34% of investors represented in the Investor Group proposed that plan so they could realize the upside of an increase in the price of the Pre-IPO Shares. The Investor Group's plan presents, however, two very important concerns: (1) the tax consequences as described in the Receiver's Plan and as briefed in her Supplement; and (2) the risk that those Pre-IPO Shares may never go public or have a liquidity event, or might not do so for years to come. As a result, the Investor Group plan (and therefore the Receiver's

plan which is built on that plan) are somewhat of a gamble, and both the best and worst case scenarios of this plan are problematic. In the best case, the Pre-IPO Shares will skyrocket in value, resulting in a large gain that will be taxable at the QSF level, to which the Investor Group objects. In the worst case scenario, the Pre-IPO company fails and the estate receives no value whatsoever for those assets.

As set forth in the Supplement and this Reply, the Receiver has questions as to whether the current plans that contemplate holding Pre-IPO Shares and returning shares to investors is workable. Accordingly, the Receiver believes that the Court and parties should reevaluate the distribution approach in this case and consider a plan designed to preserve value, eliminate risk, and mitigate tax consequences.

In summary, the Receiver's Supplement and this Reply seek:

1. Permission to file QSF tax returns for the stub period of the receivership in 2016, and for the years 2017 and 2018 (and each year going forward); and to pay any tax, interest or penalties that might be associated with those filings from receivership assets.

2. Permission to obtain valuations of the assets of the receivership as of October 11, 2016. The Receiver contemplates filing a separate administrative motion seeking approval for her engagement of a valuation firm if the Court grants this relief; however, she is also open to engaging Oxis Capital to update its valuations made early in the case.

3. Approval of the Receiver's recommendation that she be permitted to further investigate sales of Pre-IPO Shares to determine whether an alternative liquidation plan should be proposed for the Court's consideration in a separately-filed motion.

II. STATEMENT OF FACTS

1. The Investor Group filed a plan that proposed to return shares to investors (the "Investor Group Plan"). However, the Investor Group Plan did not: (a) give consideration to tax consequences of its plan; (b) protect against future risk of loss for Pre-IPO Shares with an unknown time horizon for a liquidity event; (c) address the logistics of how to generate sufficient funds for unsecured creditors since it relied on surpluses for shares that did not actually exist; (d)

address how to calculate shares to be liquidated to generate cash to pay administrative, priority, and unsecured claims as between the different investments and as between publicly-traded securities presently ready for distribution and pre-IPO shares that may or may not ever go public.

2. An additional concern with the Investor Group's Plan was that the SEC, the unsecured creditors and the Investor Group all had a different understanding of whether unsecured creditors were to receive priority payment in full ahead of investor share distributions.

3. The SEC and the former receiver had filed a separate plan that proposed to liquidate the securities and make *pro rata* distributions. They had engaged an investment banker to evaluate the possibility of liquidating the Pre-IPO Shares and who identified a secondary market on which the Pre-IPO Shares could be liquidated.

4. Upon the Receiver's appointment on February 28, 2019, the parties and the Court had been in discussions about the competing plans for well over a year. Based on the facts known at that time, the Court determined that a plan that provided for the payment to creditors of cash and the return to investors of securities was appropriate. The facts disclosed to the Court at that time were that surplus securities would fund payments to unsecured creditors if Palantir Technologies ultimately went public. However, no contemplation was given to the feasibility of how to arrange for the distribution to creditors and shareholders on a rolling basis as companies went public in a manner that would be equitable to the different classes of investors as well as to the creditors. Nor does it appear that the parties contemplated the length of time that it might take for Pre-IPO Shares to go public or the possibility that all value might be lost before a distribution could be made. Most importantly, no consideration was given to the tax consequences of the sale and distribution of securities and how the tax liability could be significantly greater the longer the wait for distribution and the greater the increase in value of the securities.

5. Upon her appointment and at the direction of the Court, the Receiver undertook to adopt the Investor Group's key plan term of returning shares to investors but to address the deficiencies in the Investor Group's Plan noted above. The Receiver filed a plan in connection with the June 27, 2019 hearing that she believes appropriately addressed the tax consequences and

1 that proposed a feasible and equitable strategy for distribution given the parameters provided.

2 6. At the June hearing, the competing positions of the unsecured creditors and the
3 Investor Group were considered and the Receiver suggested a modification to her plan that would
4 establish a Tax Holding Fund in addition to the Plan Fund so that sufficient funds would be
5 maintained to pay tax claims as well as administrative and unsecured claims. The revisions that
6 were discussed at the June hearing were identified in the Court's Minutes entered on June 28,
7 2019 (Doc. No. 503] wherein the Court stated, "The parties present did not object to either the
8 Plan Fund or the Tax Holding Fund proposal. The court agreed." Those changes have been
9 incorporated into the revised plan (the "Receiver's Plan") submitted with the Supplement.

10 7. At the June hearing, the Investor Group requested a tax opinion relating to the
11 proposed tax treatment of the receivership estate as a qualified settlement fund ("QSF"), and the
12 Court directed the Receiver to engage a tax advisor for that purpose.

13 8. In further researching the tax issues, the Receiver sought instructions from the
14 Court regarding the possibility of obtaining a ruling from the IRS if she was to take a position
15 other than the QSF position set forth in her plan. A further hearing was scheduled for October 8,
16 2019 and, at that time, additional discussions were held regarding the tax treatment under the
17 plan. The Court directed the Receiver to file supplemental papers with the Court exploring all
18 possible options for tax treatment, which resulted in the filing of the Supplement.

19 9. The Supplement reaffirms the Receiver's position set forth in June 2019 regarding
20 the proposed tax treatment for the receivership estate.

21 10. In an effort to continue to move this case forward, the Receiver also filed the
22 revised Receiver's Plan containing the revisions arising from the June hearing. The Receiver's
23 Plan is still based on the Investor Group's objectives of returning shares to investors if and when
24 there is a liquidity event or public offering. The following modifications discussed at the June
25 hearing were incorporated into the Receiver's Plan:

26 a. Cilano's claim was disallowed. Pursuant to the Court's Minutes which
27 stated, "The claim for backend fees asserted by Joshua Cilano is DISALLOWED . . ." *See*

28

Minutes [Dkt 503].

b. Although no finding was made, the parties discussed the possibility of eliminating the requirement of mandatory meetings with a committee since the Receiver was voluntarily meeting and conferring with all interested parties. The Receiver continues to communicate with all interested parties and does not believe that a committee comprised of members of the Investor Group, who constitute only 34%[1] of investors, is appropriate or necessary, or would provide a fair representation of all investors' interests in any event.

c. The Receiver's Plan contains the tax provisions that the Receiver believes are a necessary part of any distribution plan. The taxes cannot yet be quantified given the lack of tax basis valuations[2] and the price of the securities as of the date of sale or distribution, which has not yet occurred. However, the exact manner of calculation is contained in the Receiver's plan, and the uncontested legal authority supporting the tax treatment is set forth in the Supplement.

d. The Receiver's Plan identifies the tax consequences of the sale or distribution of ALL of the assets of the estate – both cash and securities – rather than randomly leaving out some assets in contradiction to well established authority. Excluding assets from the QSF will likely give rise to penalties and interest that the estate will bear, having the effect of hurting, not helping, the position of the investors.

11. In light of the Investor Group's challenge to the proposed tax treatment and the exploration of tax mitigation alternatives, the Receiver believes that renewed consideration of a different type of plan – one designed to mitigate taxes, mitigate risk, and preserve value – is

[1] Although the Investor Group timely filed a Notice of Appearance pursuant to this Court's Order to identify which investors are part of the Investor Group, counsel for the Investor Group has declined to respond to the Receiver's request for clarification regarding investors who have advised they are not part of the group and those who no longer hold valid claims. The Receiver believes that there are 110 investors in the Investor Group with allowed claims and that there are 326 total investors with allowed claims.

[2] The Investor Group objects to tax basis valuations at this time because it does not wish for the estate to pay any tax liability.

appropriate. Even since the filing of her Supplement, the Receiver has further explored possible alternatives, including selling the Pre-IPO shares on the secondary market, as was contemplated early in this case. Given the costs, delays and uncertainties of the Investor Group's Plan to delay distribution and return shares (as adopted in the Receiver's Plan), the Receiver recommends that the Court permit the Receiver to consider alternatives to both of these plans to achieve the most cost effective, efficient and equitable outcome in this case.

III THE RESPONSE'S DEFICIENCIES RE TAX TREATMENT ANALYSIS

A. No Contrary Authority Regarding Tax Treatment is Provided

The Investor Group wants its plan adopted but does not address the deficiencies in its own plan, including most importantly the absence of any proposal for tax treatment. The Response does not address the ample authority set forth in the Supplement regarding the creation of the QSF but merely reverts back to unsupported and generalized arguments made in June and October that are contrary to well-established authority. No alternative proposal is advocated or even suggested, nor does the Response actually address any of the legal authority or practical implications set forth in the Supplement.

1. A QSF Arose by Operation of Law

The Investor Group's Response makes the sweeping statement that "There are many reasons for the Court to conclude that no QSF was created here since no QSF elections, statements or tax returns have ever been filed by an Receiver as required by the IRS regulations that govern QSFs." Response at p. 2. Such a statement entirely misses the point and ignores the applicable law. The current Receiver has been asking since her first appearance in this case in June 2019 for permission to treat this case as a QSF because a QSF arose as a matter of law. The fact that no QSF return was filed by the previous receiver does not obviate the need for the current Receiver to follow the law and adhere to her fiduciary duties. The IRS tax regulations would be without meaning if the mere failure to file QSF returns excused a party from complying with the laws that are otherwise applicable.

2. All Assets of Part of the QSF

As a second argument, the Investor Group again makes the unsupported statement that only a portion of the assets become part of a QSF to the extent a QSF was created. Despite the lengthy and detailed briefing in the Supplement on this subject, the Investor Group, without contrary authority or argument, reverts back to an argument made in June that has now been discredited by a full briefing to the contrary. The Investor Group has nothing to say about the law and can only repeat the desperate arguments that (a) either a QSF does not exist because the former receiver did not file a QSF return or, (b) if a QSF does exist, only cash and not securities are part of the QSF because the Receiver Order uses the word "cash."

The Response states that "there is no language in the Receivership Order that dictates that non-cash or non-cash equivalent assets, such as the securities at issue here, were intended to be placed into a QSF." Response at p. 3. There is no requirement that express language appear in an order to establish a QSF. The QSF arises as a matter of law once the three-prong test is satisfied. This is demonstrated by rulings cited by the Receiver in the Supplement, for example, where money held in a court registry is a QSF without any order to that effect.

3. The Response Misunderstands the "Segregation" Requirement

The Investor Group interprets the "segregation" prong of the QSF requirements improperly. The Response attempts to rely on the fact that forward contracts are outstanding or "have never been physically segregated and placed in the fund that the Receivership Order contemplates as the QSF" (See Response at p. 5). This statement is incorrect as a matter of both fact and law. The segregation requirement is related to a segregation of assets from those of the Defendant or Transferor. As set forth in the Supplement, this is the express language of the Regulation. The segregation occurs when the ownership of the assets is no longer with the Defendant. Here, the Preliminary Injunction clearly terminated ALL indicia of ownership in the cash and property subject to the Preliminary Injunction and directed the Receiver to take possession and control of the cash and the property. At that moment in time, the segregation test was satisfied, and the cash and property became a part of the QSF. The Investor Group

acknowledges that the securities are "in accounts at Clear Sailing or are outstanding pursuant to forward purchase contracts." Response p. 5. Those accounts and contracts are unequivocally property of the Receivership Estate. Even the Investor Group cannot, and does not, make the argument that those assets belong to the Defendants and are outside of the control of the Receivership Estate. The Preliminary Injunction Order extinguished all indicia of ownership over shares and the futures contracts in the custody of Clear Sailing from the Defendants. The segregation test is met.

4. Individual Investors' Tax Liability is a Red Herring

a. The Receiver Must Pay Estate Tax Liability

The Receiver has addressed the estate tax liability, which is her obligation to do. She has not, and cannot, estimate taxes or file tax returns for individual investors. Nor can she remove the tax consequences that the investors may suffer when reporting gain in connection with their individual transactions, depending on the outcome of the receivership case. It is not possible to provide a tax analysis on the impact to individual investors, or to investors as a group, because they are not similarly situated and their individual tax consequences will be the result of their personal tax facts not known to the Receiver. Moreover, this is not the Receiver's responsibility nor would it be appropriate for the estate to incur the cost of tax advice for individual investors.

The QSF tax obligations are estate obligations, and the amount of any such tax liability is presently unknown. If the Receiver is authorized to file QSF returns since the inception of the case, the administrative costs in this case could serve as a credit against any tax liability that might be assessed. The Receiver cannot simply shirk the tax obligations of the estate because the investors do not wish to "indirectly" bear the cost of that estate tax liability.

b. The Response Contains Erroneous Conclusions

The Investor Group Response states, "when placed in the Receiver's QSF, the investor may recognize a gain and owe tax on that gain (unless the investor had a loss carryover to offset the gain), plus four years of interest and penalties, for the $100,000 gain in the value of the stock at the time the QSF is created." Response at 6, fn 5. This is simply an incorrect statement both

factually and as a matter of law, and no authority is stated to support this supposition.

As set forth in the Supplement, the QSF will receive a stepped up tax basis in the securities as of the date of the receivership, and any tax consequences for the estate will be tied to the difference between the value on October 11, 2016 and the date of sale or distribution. Contrary to the misstatement in the Response, the stock is not transferred from the investor at the time of the transfer to the QSF. There is no gain or loss to the investor in 2016 when the QSF came into existence and the stock (or interest in a futures contract) became a part of the assets of the QSF. The Investor Group conflates several different tax issues – some at the QSF level and some at the individual investor level. In 2016, neither the investor nor the QSF realizes a gain or loss. The QSF receives stock at its fair market value on the date of receipt. The transfer of the ownership of the stock from the Defendants to the QSF (the "segregation") does not create a tax recognition event for the QSF or the investor. The US Treasury Regulations provide that upon sale or transfer, the QSF must compare the fair market value on the date of transfer to the QSF to the fair market value on the date of transfer or sale, in order to determine if there is a gain or loss at the QSF level.

This does not create a tax recognition event for the investor. Individual investors may consult with their individual tax advisors to determine their individual tax liability based upon their "basis" in their original investment minus any tax benefit they may have taken in the interim or any adjustment in basis to which they are entitled with the amount of the payment they receive on the date of the payment from the QSF. Only then can they determine whether they have realized a gain or a loss. Whether a gain will result in treatment as gain or ordinary income will be entirely dependent on the personal tax facts in each individual investor's life. Different investors will be situated differently. Therefore, it is not possible for the Receiver to accurately analyze the tax consequences of the payments in the hands of an individual investor.

5. QSF Returns Must be Filed

Based on the unsupported and incorrect arguments relating to the tax issues, the Investor Group then requests that the Receiver be barred from filing required QSF tax returns. The

Receiver is advised that she has must treat the estate as a QSF and must file QSF returns to comply with her fiduciary duties. If the Investor Group wants to the Receiver to nevertheless take a contrary position, the Receiver can only do so upon a ruling from the IRS that she is permitted to do so. As previously explained, such a ruling will likely take 18 months and will cost tens of thousands of dollars. Given the great weight of authority to the contrary, the Receiver does not recommend this course of action.

The continued delay in bringing the QSF into compliance with its tax filing obligations will only serve to increase interest and penalties to which the QSF and the assets of the Receivership are exposed. Time is of the essence. It may be possible that the QSF will not have tax liability for the prior years considering income and the expenses of administration. This is not knowable without a valuation of assets and the authority to prepare and file the returns. Therefore, the Investor Group is correct in stating that the exposure is not known, but it continues to prevent the ascertainment of this exposure by opposing the simple business steps of valuation and preparation and filing of tax returns.

B. The Expense, Uncertainty, and Time Horizons of the Investor Group Plan

1. Taxes and Creditors' Claims are Not "Costs"

The Investor Group asks for a comparison of the Receiver's plan to "another plan," although it is not clear which of the Receiver's plans the Investor Group refers to, or what "other plan" they wish her to compare it to. The Receiver's Plan, like the Investor Group's Plan, requires waiting until the Pre-IPO shares go public or have a liquidity event, both of which have similar costs and delays attendant to them. However, the Receiver's Plan addresses the payment of applicable tax liability. The issue of tax treatment appears to be the primary concern of the Investor Group.

The Response appears to largely complaint of only two types of "costs" – taxes and valuations. Both of those "costs" are not actually costs that the Receiver is electing to incur. Rather they are obligations that the estate must incur in order to lawfully comply with federal and state tax regulations. These costs related to taxes are the only meaningful cost distinction between

the Investor Group's Plan and the Receiver's Plan.[3]

The Investor Group wishes to promote a plan that provides for shares to be returned to investors without mind to tax consequences or how unsecured creditors will be paid. No specific strategy has been, or is now, proposed as to how to accomplish that objective. The Receiver cannot ignore her obligations to pay taxes so, if no QSF returns may be filed, the costs and delays have been identified relating to obtaining an IRS ruling that may or may not grant the Receiver permission to disregard a QSF in this case.

Moreover, the cost of valuing the assets of the estate as of the date of the Receivership is a constant cost irrespective of the nature of the plan that is ultimately approved as such valuations are a necessary part of establishing the tax basis in those assets. The Investor Group requests that the Receiver be barred from obtaining valuations to establish tax basis. However, ironically and inexplicably, the Investor Group complains that there is no base line valuation to establish the amount of tax liability, yet wants to deny the Receiver the ability to retain a valuation firm to establish that valuation. The Investor Group's Response is internally inconsistent and does not appear designed to move this case forward in any respect.

2. Returning Shares to Investors Causes Delays and Risk

In addition to missing the point on "costs," the Investor Group also ignores the issues with delays that their approach has caused and is continuing to cause. Their Plan, and the Receiver's Plan, both require waiting for all of the Pre-IPO Shares to go public or have a liquidity event. The delays are unknown, but could be years. The costs from waiting are also unknown, as no one can predict how the stock market will behave in the interim. Additionally, the Investor Group's Plan does not provide for how or when the Receiver would distribute shares that are already public, because it is unknown what other shares will go public and how many shares of the already public

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[3] The Receiver's Plan provides for liquidation of shares in an amount equal to 30% of the amount originally invested on a company by company basis to create a Plan Fund, and additional shares to create the Tax Holding Fund to pay taxes. The are administrative costs associated with this type of plan that would be the same as the administrative costs under the Investor Group's plan in terms of calculating the number of shares to be sold versus distributed and in effectuating the transfer of securities to individual investors. .

shares should be liquidated to pay unsecured creditors.

The Investor Group does not wish for the Receiver to "speculate in the securities market." Response at p. 8. The Receiver agrees and does not wish to do so either. However, the current plans have the effect of asking the Court, the Receiver, and the investors to speculate in the securities market. The Pre-IPO Shares may or may not go public. The publicly-traded shares may increase or decrease in value. The longer this case remains open with no distribution plan in place, the longer all parties are speculating.

An alternative to stock speculation and indefinite delays would be a liquidation approach, that would provide certainty and finality, as opposed to either the Investor Group's Plan or the Receiver's Plan. As described more fully below, the Receiver seeks authority to investigate whether the Pre-IPOs shares could be liquidated at this time in connection with a liquidation plan.

IV. ISSUES WITH RETURNING SHARES TO INVESTORS

The Investor Group's original plan, and therefore the Receiver's Plan, bears substantial risk if the Pre-IPO Shares do not go public, on the one hand, or will generate significant tax liability if the shares increase substantially in value, on the other hand. Either way, there is no defined time period when a distribution could be made since it is unknown when, or if, the shares will go public. Therefore, the plans cannot fully address the logistical challenges raised by the uneven timing of stock distributions or sales as liquidity events occur, and how an equitable result could be achieved for both investors and creditors.

Some of the unresolved and problematic issues are as follows:

1. **Publicly Traded Securities**: For the publicly traded shares already in the Receiver's possession, if these are sold and distributed, how many shares should be liquidated versus distributed?

a. The Investor Group's Plan did not contemplate these logistics, and it was not clear how much of a given security would be sold versus distributed or how much would be paid to unsecured creditors. It was also unclear how to spread the payments to be made to unsecured creditors among the different classes of investments, especially given the uneven timing of when

the securities would go public or have liquidity events. These deficiencies, in addition to the absence of tax considerations, made the Investor Group's Plan unfeasible, which led to the revisions contained in the Receiver's Plan.

b. The initial version of the Receiver's Plan first proposed in June 2019, contemplated the creation of the Plan Fund equal to 30% of the amount invested for a particular security to fund administrative, tax and unsecured claims (the "30% Plan Fund"), but the unsecured creditors objected that the 30% might be used entirely for taxes, leaving them with little to no return.

c. The revised Receiver's Plan filed in connection with the Supplement creates a Tax Holding Fund in addition to the Plan Fund so that unsecured creditors are assured a piece of the Plan Fund after administrative claims are paid in full.

d. However, there remain potential issues with the 30% Plan Fund which may disproportionally and negatively affect investors. The 30% Plan Fund might eliminate any distribution whatsoever to certain classes of investor claimants if the share price is too low. If the share price drops significantly, there may only be enough shares to liquidate to create the Plan Fund and few to no shares remaining to distribute to investors. In other words, investors could receive nothing, and all of the cash generated will go to creditor payments.

2. **Pre-IPO Securities**: The Investor Group and Receiver Plans both are open-ended in terms of time for distribution as well as ultimate value because value from the Pre-IPO shares can only be realized under the plans at such time as those companies go public or have a liquidity event. Not only could this take years, but it might also never happen. The end date for distribution, therefore, is unknown and could result in this case staying open indefinitely. As set forth below, one option to resolve this uncertainty, which would also mitigate tax liability, would be liquidation of these securities on the secondary market.

3. **Distribution Challenges**: The Investor Group Plan and the Receiver's Plan both require complex calculations to allocate cash and securities to investors and creditors. Additionally, the Receiver will be required to communicate with each of the several hundred

investors and their brokers to arrange for the transfer of securities, if they have their own brokerage accounts. If they do not have such accounts, the Receiver will need to work with the investors to establish accounts to arrange for the transfer of securities. The administrative costs of such a distribution plan that requires the return of shares will be significantly greater than a more simplified pro rata liquidation cash plan.

4. **Special Purpose Entity Challenges**: The Investor Group appears to have dropped its request that the Receiver form a special purpose entity as part of a distribution plan to try to mitigate tax liability. As set forth in the Supplement, the creation of an SPE to handle the distribution of shares to investors is wrought with substantial hurdles and significant costs.

V. ALTERNATIVE LIQUIDATION APPROACH

The Receiver believes that consideration of a streamlined liquidation plan is appropriate at this time in light of the uncertainty of the timing and outcome of the Pre-IPO shares and the potential tax consequences. A Liquidation Approach would allow the Receiver to sell both publicly traded and pre-IPO shares in the near term and do a relatively simple pro rata calculation for distribution purposes. The need to generate calculations on a rolling basis for a Plan Fund and Tax Holding Fund would be eliminated, as would the risk of loss and delay from pursuing a plan that seeks to return shares to investors. Additionally, tax liability would be mitigated as the Pre-IPO Shares could be liquidated before any large gains are assessed to the QSF. Investors would be, and are, free to repurchase the securities on the secondary market and hold them pending the IPOs and high values they hope for.

The Receiver is advised that the Pre-IPO shares that are owned by the estate outright can be sold on a secondary market before a public offering or a liquidity event. The Receiver is further advised that the price of all or most of those securities has remained relatively constant throughout the duration of this receivership proceeding, so that the tax consequences from such a sale might be minimal. She believes it is appropriate for her to further explore the possible benefits and feasibility of this approach.

1 Rather than gambling on a potential huge upside if and when the Pre-IPO shares go public
2 as has been promoted by the Investor Group, which will have sizeable tax consequences, another
3 option is to sell those shares on the secondary market in the near term, thereby mitigating tax
4 liability as the price has not appreciated significantly during the receivership, and allowing the
5 Receiver to get funds back into the hands of the investors and creditors. If the investors so desire,
6 they can repurchase shares of the Pre-IPO companies on the secondary market and hold those
7 shares pending a public offering or other liquidity event, outside of the parameters of the
8 receivership, to realize on the hoped for upside if and when those companies go public.
9 Accordingly, it is the Receiver's recommendation that she be permitted to further
10 investigate sales of pre-IPO Shares and, if feasible and deemed to be in the best interest of the
11 estate, to propose a liquidation plan for the Court's consideration. Such a plan would propose that
12 the Receiver liquidate both public and pre-IPO securities.

13 **VI. CONCLUSION**

14 The Receiver respectfully requests the Court: (1) provide instructions as to which approach
15 to pursue for distribution; (2) authorize the filing of QSF tax returns and any required information
16 returns for 2016, 2017, 2018 and 2019, and all years going forward; (3) authorize the Receiver to
17 proceed with valuation of the Receivership assets as of the date of creation of the receivership; and
18 (4) grant all other appropriate relief.

19 DATED: January 21, 2020

DIAMOND McCARTHY LLP

20 By: */s/ Christoper Sullivan*
21 Christopher Sullivan, Attorney for
Kathy Bazoian Phelps, Successor Receiver

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