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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

JOHN V. BIVONA, et al.,

Defendants and Relief Defendants.

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

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S OBJECTIONS TO RECEIVERSHIP CLAIMS BY MICHELE MAZZOLA AND JOSHUA CILANO FOR MANAGEMENT FEES

Date: April 7, 2020
Time: 10:30 a.m.
Courtroom: 5
Judge: Edward M. Chen

I. Introduction

Over two years ago, the Court rejected the receivership's payment of claims to defendants, relief defendants and insiders. Based upon prior rulings and the current distribution plan, plaintiff Securities and Exchange Commission ("Commission" or "SEC") hereby objects to the claims for fees from the receivership by former relief defendant Michele Mazzola and former insider Joshua Cilano. Pursuant to the Stipulated Briefing Order dated February 19, 2020, the SEC's Objection will be heard by the Court at 10:30 a.m., on April 7, 2020. ECF 566 at 1.

Michele Mazzola and Cilano lack any basis for seeking fees from the receivership; their fees claims necessarily derive from the fee claims by defendants and relief defendants that the Court previously rejected. *See* ECF 246 at 22, 28. Additionally, the Court rejected claims by persons who were insiders or who financially benefitted from the improper commingling of investor funds. *Id.* at 24-25. During the fraudulent scheme, Michele Mazzola received $1.8 million in diverted investor money, while Cilano received large commission payments for raising investor money. Equitable principles, and the Court's prior rulings, therefore preclude Michele Mazzola and Cilano from receiving fees in the receivership.

II. Legal Argument

A. Michele Mazzola and Cilano Do Not Have A Basis For Claiming Fees.

Michele Mazzola's Claim contains a conclusory request for management fees and carried interest fees from 2012 to the present. Attachment 1 at 3-5. Cilano's Amended Claim makes a similar conclusory request for "50% of Backend Fees from Transactions I introduced or initiated." Attachment 2 at 3. Notably, Mazzola and Cilano have not submitted a written contract to establish an independent, contractual right to fees. At most, Michele Mazzola vaguely asserts that her right to fees is supported by the "operating agreements of all the entities listed [on the claim form]." Attachment 1 at 4, 5.

In actuality, Mazzola and Cilano assert a derivative claim for management fees. That is, they apparently seek a portion of the management fees that investors supposedly owed to the management entities – i.e., SRA Management, LLC, FMOF Management Associates, LLC ("FMOF Management") and NYPA Management Associates, LLC ("NYPA Management") – in connection

with their purchase of pre-IPO interests. According to the Private Placement Memoranda ("PPM") for the sale of pre-IPO interests to investors, the SRA, FMOF and NYPA Management entities could collect "backend fees" from investors in the form of accrued annual management fees, performance fees and carried interest, which is a 20% net profit share, following liquidity events such as an initial public offering. *E.g.*, SRA Fund I Private Placement Memorandum at 9, 10, 11 (ECF 8-3 at 22, 23, 24). Michele Mazzola apparently seeks management fees as an owner, or part owner, of the Management entities. Similarly, Cilano seeks half of the backend fees supposedly owed by investors to SRA Management, FMOF Management, or NYPA Management for the investments specified in his Amended Claim. Appendix 2 at 5-8 (redacted version).

Under this Court's prior rulings, however, SRA Management, FMOF Management and NYPA Management may not collect fees from the receivership, and will therefore leave Mazzola and Cilano without any fees to claim. On September 13, 2017, this Court rejected any claim by defendant SRA Management, the other defendants, relief defendants and insiders, with the exception of Anne Bivona. Order Regarding Plaintiff SEC and Receiver's Request for Preliminary Findings Related to Proposed Joint Distribution Plan ("Order Regarding Preliminary Findings") at 22 (ECF 246). Hence, this Court expressly barred claims by Michele Mazzola. *Id.* Additionally, the Court wrote that "Defendants' counsel confirmed that Defendants would not file a claim to recover any management or advisory fees. Accordingly, the issue is moot and the Court need not resolve whether their conduct would have justified barring them from doing so." *Id.* at 27-28. Purported management fee claims by SRA Management, FMOF Management, or NYPA Management were therefore withdrawn years ago.

Consistent with the Order Regarding Preliminary Findings, the Receiver's proposed Revised Distribution Plan precludes any claims by SRA Management, FMOF Management and NYPA Management by categorizing such claims as "Disallowed Claims." Proposed Revised Distribution Plan at II (ECF 570-1 at 11). Because claims by SRA Management, FMOF Management and NYPA Management are excluded by the Receiver, Michele Mazzola's and Cilano's derivative claims for a

share of those entities' fees must necessarily fail. Mazzola and Cilano cannot logically obtain any fees from entities that are themselves precluded from receiving fees.[1]

B. Equitable Principles Preclude Mazzola and Cilano From Receiving Fees.

The Proposed Revised Distribution Plan also excludes claim by insiders by treating such claims as "Disallowed Claims." ECF 570-1 at 11. As this Court previously ruled, "if the claim, by its very nature, involves a profit from the fraud earned, e.g., through actively inducing others to join, equity may require exclusion." Order Regarding Preliminary Findings at 24-25 (ECF 246). Precluding recovery by insiders who were involved with, or benefitted from, a fraudulent scheme "is eminently reasonable and is supported by case law." *SEC v. Byers* 637 F. Supp. 2d 166, 184 (S.D.N.Y. 2009) (approving distribution plan that excludes insider participation in recovery). Named defendants may be excluded from a recovery plan. *See SEC v. Basic Energy & Affiliated Res.*, 273 F.3d 657, 660 (6th Cir. 2001) (affirmed plan precluding any recovery for defendants and reducing recovery for employees based upon level of involvement). Parties who contributed to the failure of entities in a receivership has also been upheld. *SEC v. Enter. Trust Co.*, 2008 U.S. Dist. LEXIS 79731 at * 10, 17 (N.D. Ill. Oct 7, 2008) (upholding exclusion of former owners as being a common, least contested distribution plan feature and stating that insiders were not "innocent victims").

Michele Mazzola is an insider who should not receive fees from the receivership. During their fraudulent scheme, defendants diverted $1.8 million in SRA investor money to Michele Mazzola. Declaration of Ellen Chen at 26-27 (ECF 14 at 27-28). On December 22, 2017, the Court entered a stipulated Final Judgment against Frank and Michele Mazzola whereby Michele Mazzola agreed to disgorge $1.8 million as her alleged ill-gotten gains. ECF 295 at 4. Michele Mazzola has not paid a penny of this Court's disgorgement order against her. Using receivership assets to pay fees to her would be patently inequitable.

The record also establishes that Cilano is an insider who should not profit further from his

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[1] Cilano has not provided any direct agreements between himself and investors to pay him fifty percent of the backend fees. Such investor agreements would be prohibited, in any event, unless disclosed in writing to brokerage firm(s) employing Cilano. Financial Industry and Regulatory Authority ("FINRA") Rule of Conduct 3040(b) (requiring detailed written notice to employer of proposed transaction and compensation), *replaced by* FINRA Rule of Conduct 3280(b) in May 2015.

sales to investors. As the SEC previously demonstrated, Cilano sold investments for defendants Felix Investments and Saddle River Advisors while employed by Alexander Capital. Supplemental Declaration of John S. Yun ("Yun Supp. Decl."), Ex. 2 [Susan Diamond Testimony, p. 111:11-14] (ECF 240 at 26). From August 2014 through April 2015, defendants Saddle River Advisors, John Bivona and SRA Management paid a total of $674,634 in fees and commissions to Cilano. Yun Supp. Decl., Ex. 3 [Bivona Testimony, pp. 88:23-89:2]; Declaration of Monica Ip, CPA ("Ip Supp. Decl.") ¶¶ 1-6 and Exhibit 1 (ECF 240 at 35-36; ECF 239 at 2-3, 5). Cilano raised the second largest amounts of investor money in the SRA, FMOF and NYPA Funds, after John Bivona. Yun Supp. Decl., Ex. 3 [Bivona Testimony, pp.90:2-91:12] (ECF 240 at 37-38). The spreadsheet attached to Cilano's Amended Claim identifies over 120 separate investor transactions that Cilano asserts to have introduced or instigated. Cilano Amended Claim at 5-8.

Cilano therefore collected large commission payments from selling pre-IPO interests to numerous investors. While Cilano was selling pre-IPO interests and collecting large commission payments, Saddle River Advisers and John Bivona were operating a fraudulent scheme, commingling investor money and misappropriating investor funds. ECF 4-20 (motion for temporary restraining order, asset freeze and preliminary injunction). Having the receivership provide additional compensation to Cilano would be inequitable. *See* Minute Order for Proceedings on June 27, 2019, Order (3) (stating "claim for backend fees asserted by Joshua Cilano is DISALLOWED as it would be inequitable for Cilano to receive additional compensation for his role in Defendants' scheme at the expense of the investors, even if Mr. Cilano was not personally culpable") (ECF 503 at 1-2).

C. Awarding Fees to Mazzola or Cilano Would Burden the Receivership.

Providing fee compensation to Michele Mazzola or Cilano would also impose a heavy burden upon the receivership. As demonstrated above, the Revised Plan disallows claims (i) for management fees, (ii) by the SRA, FMOF and NYPA Management entities and (iii) by insiders. As a result, there are no receivership assets allocated for paying fees to Michele Mazzola or Cilano. To pay fees to Mazzola or Cilano, the receivership must impose a special assessment upon investors.

Given Michele Mazzola's failure to pay her $1.8 million disgorgement obligation, it would be especially improper to allow her to collect money from the receivership's investors. She and her

husband, Frank Mazzola, should be paying money, not seeking money. Any money or assets that the Mazzolas acquire would be immediately subject to attachment and seizure by the SEC. Similarly, Cilano should not receive any more compensation for his sales of securities when there are unpaid investors who will receive little, or nothing, from the receivership or who must contribute a substantial portion of any recovery to effectuate the plan.

III. Conclusion

For the reasons set forth above, the Court should deny Michele Mazzola's Claim and Cilano's Amended Claim for fees from the receivership.

DATED: February 28, 2020

Respectfully submitted,

/s/ John S. Yun
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SECURITIES AND EXCHANGE COMMISSION