JINA L. CHOI (N.Y. Bar No. 2699718)
JOHN S. YUN (Cal. Bar No. 112260)
yunj@sec.gov
MARC D. KATZ (Cal. Bar No. 189534)
katzma@sec.gov
JESSICA W. CHAN (Cal. Bar No. 247669)
chanjes@sec.gov
Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION
44 Montgomery Street, Suite 2800
San Francisco, CA 94104
(415) 705-2500

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 REPLY TO OPPOSITIONS TO MOTION FOR APPROVAL OF PROPOSED JOINT DISTRIBUTION PLAN** Date: September 28, 2017 Time: 1:30 p.m. Courtroom: 5 Judge: Edward M. Chen

I. Introduction

Plaintiff Securities and Exchange Commission ("Commission" or "SEC") submits this Reply Memorandum to demonstrate that the Receiver's and the Commission's Joint Distribution Plan provides the most fair and equitable outcome for all investors in receivership entities Felix Multi-Opportunity Funds I and II, LLC ("FMOF Funds"), NYPA I and II, LLC ("NYPA Funds"), SRA I, II and III, LLC ("SRA Funds") and Clear Sailing IV and V, LLC. The Commission makes this additional submission to address the objections and proposal of SRA Investor Group (Dkt. 229), as the Commission has previously responded to the objections of the Bivonas, the Mazzolas and others, which the Court heard during the August 30, 2017 hearing.

The Court should adopt the Joint Distribution Plan, as it is fair and reasonable and presents the best means to address the uncontroverted evidence of securities fraud, misappropriation and commingling that required placement of the Funds and Clear Sailing into receivership in the first place. Critically, the limited objections to the Receiver's and Commission's Joint Distribution Plan, from a group describing itself as "SRA Funds Investors Group," led by defendant John Bivona's business associate, Joshua Cilano, are without merit. Indeed, because the objections are largely founded on factual inaccuracies, as described below, they appear to be offered simply to give credence to Cilano's alternative plan, which would put him in control of the Funds and any future distribution to investors.

Cilano's alternative plan, like his objections, should be rejected. Cilano is a long-time Saddle River Advisors broker who aggressively raised money from investors in the same manner as John Bivona, Frank Mazzola and Felix Investments. Cilano's new plan is a proposal to extend his insider-status over the Funds with the imprimatur of the Court. However, his plan is fatally flawed for many reasons. For instance, there is no evidence that he disclosed – either to the Court, or even to the group he purports to represent – his own background, including his leading role in raising money from investors and his receipt of nearly $675,000 in commission and other payments from Saddle River Advisors, SRA Management and John Bivona. Most importantly, Cilano's alternative plan is contrary to equitable principles. Accordingly, the objections should be overruled and the Court should adopt the SEC's and Receiver's Joint Distribution Plan.

II. Relevant, Undisclosed Facts Regarding Cilano and His Proposal

Joshua Cilano is the person who the objecting group has suggested as a proposed manager. Cilano himself formed "Investor Rights, LLC," hired counsel, and organized and "personally communicated with" the investors in order to make the proposal that is a part of the SRA Funds Investor Group objections. Cilano Decl., ¶¶ 4-6 (Dkt. 231). Cilano states that it is his belief that he will require the Investor Group to contribute additional funds beyond their investments to date; in particular, he claims the group of investors he has enlisted to date have "committed to contribute up to $5 million," and he "believe[s] that SRA Funds investors likely will come forward with further contributions" if needed. *Id*. ¶ 7.

A long-time business associate of John Bivona and Frank Mazzola, Cilano sold investments for 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]. In the Summer of 2014, Cilano joined another salesperson at Saddle River Advisors to fill the gap created when Defendant Mazzola was supposed to cease soliciting investors for the Funds. Yun Supp. Decl., Exs. 2, 3 [John Bivona Testimony, pp. 64:19-66:3; Susan Diamond Testimony, pp. 135:24-136:19]. Cilano received commission and other payments for such sales, and during the period from August 2014 through April 2015, Saddle River, John Bivona and SRA Management paid him a total of $674,634. 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. Cilano raised the second largest amounts of investor money in the Funds, after John Bivona.[1] Yun Supp. Decl., Ex. 3 [Bivona Testimony, pp.90:2-91:12].

The Investor Group proposes that the management of the Funds under Cilano's alternative plan would be "subject to oversight by the advisory committee," and they claim specifically: "All of the members of the advisory committee are independent from Investors Rights." Cilano Decl., ¶ 8; Investor Group Objection at 20. The first two members of the advisory group are not, however,

[1] And John Bivona even notarized key corporate documents for Cilano's related business, Capital Truth Holdings. *See* Reply Declaration of Marc D. Katz ("Katz Decl."), ¶ 1 and Ex. 1.

"independent from" significant business dealings with Cilano. Peter Healy, the first proposed committee member, has been in business with Cilano since 2015. Katz Decl. ¶¶ 6-10 and Exs 1-3. Further, Healy took a significant ownership stake (20%) in Capital Truth Holdings, and along with Cilano, was identified as a person who is permitted to make securities transactions for funds it manages. *Id*. ¶¶ 7-10 and Exs 1-4. Finally, Healy and the second proposed advisory committee member, Robert Brunner, were both listed as "advisory board members" of Cilano's separate advisory business, Capital Truth Advisors, on a now-deleted page of its website. *Id*., ¶¶ 11-12 and Ex. 4.

Cilano himself has never been associated with a registered investment adviser, and instead purports to "consult" with investors. Cilano Decl., ¶ 3. Cilano has been a registered representative (that is, a securities broker) at various brokerage firms, including four firms that were expelled by the financial industry regulator, FINRA. Yun Supp. Decl., Exhibit 1. Finally, Cilano has five outstanding tax liens against him, totaling $140,019. Yun Supp. Decl., Ex. 4. Such liens raise concerns about whether he is able to manage his own financial affairs responsibly.[2] Cilano's Declaration and the Investor Group objections are silent as to whether any of the above facts were disclosed to any investors before the alternative plan was submitted.

III. The Objections to the Joint Distribution Plan Lack Factual Basis

Prior to proposing the Joint Distribution Plan, the SEC and the Receiver made meaningful efforts to answer questions and obtain opinions from investors and their representatives. To this end, the Commission's counsel met with persons associated with the Investor Group prior to filing the Joint Distribution Plan. Katz Decl. ¶ 13. In addition, after filing the Joint Motion, the SEC and the Receiver agreed by stipulation to extend the time for the a submission by the Investor Group, in order to afford them time "to confer with the Commission and the Receiver about its alternative plan in advance of it being filed with the Court." Stipulation and Order at 3 (Dkt. 208). However, the SEC

---

[2] In the securities industry, tax liens are viewed as material information that should be disclosed to investors as bearing upon the registered representative's qualifications. *See, e.g., In the Matter of the Application of Robert D. Tucker*, Exchange Act Release No.68210, 2012 WL 5462896, at *9 (Nov. 9, 2012), *appeal dismissed*, No. 13-31 (2d Cir. Sept. 24, 2013); *In the Matter of the Application of Michael Earl McCune*, 2016 SEC LEXIS 1026 at * 10-12 & n. 11 (May 15, 2016).

did not hear from the Investor Group until the SEC saw the filings. Accordingly, the SEC addresses here why those objections are not well founded, and are in fact contrary to the evidence.

Cilano and the Investor Group first object based on their belief that Global Generation would receive an improper advantage under the Joint Distribution Plan. Investor Group Objection at 13. This objection is misplaced. Like all other investors and unsecured creditors, Global Generation has a monetary claim (not a claim to Palantir shares) under the proposed Joint Distribution Plan. Global Generation's claim would be based upon the principal out-of-pocket amount of its Palantir investment minus any repayments and distributions it received. Because the Joint Distribution Plan does not envision distributing actual shares, Global Generation will not receive any windfall.

Cilano and the Investor Group further assert that there is no actual shortfall in Palantir shares because Global Generation exercised its redemption rights for its Palantir shares and now has a judgment for the unpaid amount. Investor Group Objection at 14. Contrary to this argument, Global Generation cannot be said to have surrendered its Palantir shares until an actual "settlement" of the redemption transaction – and "settlement" requires the actual payment of the redemption price by the FMOF Funds.[3] Global Generation's unredeemed Palantir shares are properly included in the Commission's shortfall analysis because those shares are stilled owed to Global Generation until the redemption price is paid.[4]

Cilano and the Investor Group next blame Sherwood Partners for the Square distribution shortfall. Investor Group Objection at 16, 18. At the time of the Square distribution in August 2016, Sherwood Partners was serving as an independent monitor of Saddle River Advisors, SRA Management, the SRA Funds, Clear Sailing and Felix Investments. Stipulated Monitor Order at 1

---

[3] "[S]ettlement is generally the term applied to the exchange of payment to the seller and the exchange of securities to the buyer of a trade. It is the final step in the lifecycle of a securities transaction." Yun Supp. Decl., Exs. 5, 6.

[4] Cilano also makes the baseless objection that the Joint Distribution Plan improperly compensates investors whose pre-IPO companies ultimately prove to be unsuccessful and do not have a profitable liquidity event. Investor Group Objection at 15-16. This argument ignores, however, that due to defendants' fraudulent scheme and commingling, no investor's money was necessarily used to purchase the pre-IPO shares sought by the investor. Instead, all investor funds were fraudulently commingled, and all investors are therefore victims of fraud.

(Dkt 90). The Order provided, with respect to the Square distribution, that "Saddle River, Bivona and Clear Sailing shall certify that to the best of their knowledge and reasonable investigation that the proposed distribution encompasses all of the investors and all of the shares." *Id.*, ¶ 11 at 3. Indeed, the Order expressly determined that Sherwood Partners was not responsible "for the operation" of those entities, or "for the preservation or sale of any assets." *Id.* at 4. The objection is thus contrary to the factual record.

In any event, the Joint Distribution Plan will address the misallocation of Square shares. According to the consolidated investor list that John Bivona provided to the Receiver in October 2016, three of the four Square investors who received excess shares are investors in other pre-IPO companies, including Palantir. As a result, the excess Square shares can serve as an off-set to those investors' future distributions. To the extent necessary, the Receiver can also bring a claw-back action for the excess Square shares.[5] The Court should therefore reject Cilano's objections based upon the Square distribution issues.[6]

IV. Cilano's Proposal Is Neither Fair Nor Equitable, and Is Factually Unsupported

As described in the Joint Motion, the SEC's and Receiver's Distribution Plan is fair and equitable in proposing a *pro rata* distribution, particularly in light of the facts in this case flowing from defendants' extensive commingling. Commission's Joint Motion at 11-14 (Dkt. 197). Cilano and the Investor Group nevertheless propose a competing plan. Although the Commission's staff acknowledges the appeal of any plan that would fulfill the investors' original expectation and hopes, that is simply not feasible in this case. Investors might have thought they had invested in an opportunity to share in the profit from the increased value of shares in a particular company after it experienced an IPO or another "liquidity" event. But the fraud irrevocably robbed them of this opportunity; the Joint Distribution Plan attempts to best rectify a bad situation. As an initial matter,

---

[5] The Investor Group's counsel claims to represent Kevin Smith, Dkt. 189 at 2, who is one of the four investors who received an over allocation of Square shares and whom the Investor Group's counsel says should have been sued by the Receiver to recover any excess Square shares.

[6] The issues raised in the letter from Mr. Harivel (Dkt. 213) are addressed above. Mr. Harivel objects to a sale of the receivership portfolio and consolidated pro rata distribution, as does the Investor Group and Cilano. Mr. Harivel's counsel is also counsel for the Investor Group.

however, any plan – even if proposed by a group that purports to represent the majority of investors – must satisfy the equitable standard of being fair and reasonable. *See SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991) (ruling that a court may approve any plan of distribution that is "fair and reasonable"). However, the alternative plan falls far short of the basic requirement of being fair and reasonable as described below.

In *SEC v Schooler*, the district court faced an analogous situation where the Commission and receiver proposed a *pro rata* distribution plan, while some of the general partners proposed that former management should be allowed to take several general partnerships out of the receivership and then sell the general partnerships' assets. 2015 U.S. Dist. LEXIS 46871 (S.D. Cal. March 4, 2015). In its first opinion on the distribution plan, the district court rejected the proposal to allow some general partnerships to exit the receivership under former management because it created the risk of "perpetuating the fraud." *Id.* at * 30-31. In a further ruling, the district court described factors that should be considered before allowing some general partnerships to exit the receivership, including the proposed governance structure of the exiting general partnerships. *SEC v. Schooler*, 2016 WL 3031824 at * 11 (S.D. Cal. May 25, 2016). Here, as well, close consideration should be given to any proposed governance structure. While the Commission is not opposed to the creation of an advisory committee with clearly established responsibilities, it is important that any member of such committee be fully vetted and that any actual or potential conflicts be disclosed to the investors, the Commission and the Court. Similarly, any proposed new management must be qualified and beyond reproach.

In considering Cilano's management qualifications, his professional background is important. Cilano's Declaration states only that he has "more than seventeen years of experience in the securities industry" and is the founder, principal and manager of Capital Truth Advisors LLC. Cilano Decl., ¶ 2. But as described above, Cilano is closely associated with the enterprises that spurred this fraud and caused the need for the receivership in the first place. There is no evidence that Cilano has informed the Investor Group of his close association, including his important role in selling securities for John Bivona, Saddle River and the SRA Funds, and the significant payments, of more than $600,000, he already received. Cilano certainly did not apprise the Court of that information.

Moreover, his association with Bivona did not end with the SRA funds, as Bivona was present for the establishment of Cilano's Capital Truth venture.[7]

Just as critically, the competing plan does not treat all investors fairly and is not based on factual support, as it pretends that the fraud never occurred. Cilano's alternative plan thus ignores defendants' fraud and commingling and instead presumes that investors can receive a distribution of shares in the particular pre-IPO company in which they believed they invested, without recognizing that other investors' money was used for such purchases. For instance, Cilano's plan provides that *if* there is a liquidity event for a *specific* pre-IPO company, such as Bloom Energy, the investors who think they invested in that company will receive the proceeds from the liquidity event, minus the accrued management fees and carried interest owed to the managers under the existing management agreements. Investor Group Objection at 22. But that assumption ignores the reality: because money was commingled and misappropriated, and the records are not reliable, it is not possible at this point to complete the tracing that would be necessary to make this option available. That is why, in case after case, courts resort to pro rata distribution plans in the face of extensive commingling. *See SEC v. Byers*, 637 F. Supp. 2d 166, 178, 184 (S.D.N.Y. 2009) (approving *pro rata* distribution plan in light of commingling and fraudulent conduct). *See also United States v. Real Property Located at 13328 and 13324 State Highway 75 North*, 89 F.3d 551, 553-54 (9th Cir. 1996) (approving plan to have all investors recover from real property that was purchased with money from a particular investor).

Indeed, as Sherwood Partners previously informed the Court, the receivership entities' books and records are not reliable and it might be necessary to publish a notice in major newspapers to help ensure that all investors and creditors submit a written claim. Independent Monitor's Report, dated May 10, 2016, at 13 (describing proposed notice publication in periodicals such as the *Wall Street Journal* due to unreliable recordkeeping of investor lists and transactions) (Dkt. 74). By comparison, Cilano's alternative plan does not attempt to locate investors who have been left off the investors' lists and apparently assumes that all investors have already been accounted for.

---

[7] Katz Decl. ¶ 7 and Ex. 1

Cilano's plan also fails to treat investors fairly in other material respects. For instance, Cilano does not explain how those receivership entity investors who have not joined Cilano's investor group, apparently twenty-five percent of the investors, will be treated. If those investors are excluded from the entities to be managed by Cilano, then they are excluded from any chance of a recovery and punished for not going along with Cilano's alternative plan.

By design, Cilano's plan is inequitable, as he suggests that he would, in the future, treat investors differently based on their willingness or ability to pay more money. In their proposal, Cilano and the Investor Group state that they have received commitments (from unidentified investors) for $5 million in new money.[8] The SEC does not support the notion of requiring defrauded investors to pay more money in order to receive a distribution. Moreover, Cilano has pledged to use the $5 million he expects to collect to pay some distribution to certain claimants, and to give priority to persons who put in new money.[9] In contrast, the Joint Distribution Plan is equitable, as it offers a consolidated *pro rata* recovery for all investors. *See United States v. Real Property Located at 13328 and 13324 State Highway 75 North*, 89 F.3d at 553.

Finally, in addition to the significant equitable shortcomings, the plan proposed by Cilano and the Investor Group appears doomed to failure for purely practical reasons. As described above, Cilano relies heavily on the notion of new money injected by the investors in the future, but he does not say how much or from whom. He also has not described what he would use to substitute for the lack of reliable records in determining how future distributions should be made. In contrast to the Joint Distribution Plan which calls for the orderly sale of the receivership's assets over the next two years, Cilano's alternative plan would supposedly hold the pre-IPO shares until a liquidity event

---

[8] There are no details provided as to the terms or sources of the purported "commitments" for "up to" $5 million. The proposal does not describe whether all investors have made such a commitment, or only some, nor does the proposal establish that this money is being raised from investors in compliance with the federal securities laws.

[9] Under Cilano's alternative plan, the 2% annual management fees that have accrued before he takes over and become due upon a liquidity event are pledged to repaying the $5 million advance. All management fees accruing after Cilano takes control and all carried interest payments (20% of gains) belong to Cilano, even though he is apparently not putting any of his own money into managing the Funds and Clear Sailing.

occurs – which gives no ending date. Finally, and most importantly, Cilano's alternative plan only vaguely refers to reporting to the Court, and does not specifically provide for Court supervision of the operations, expenditures and business decisions of the new management, while taking away the protections provided by the receivership.

V. Conclusion

For the reasons set forth above, and in the respective Motions by the Commission and by the Receiver, the Court should approve the proposed Joint Distribution Plan and overrule the objections.

DATED: September 13, 2017

Respectfully submitted,

/s/ John S. Yun
John S. Yun
Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION