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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

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

THE SRA FUNDS INVESTOR GROUP'S BRIEF IN SUPPORT OF PROPOSED ALTERNATIVE DISTRIBUTION PLAN

Date: October 28, 2018
Time: 1:30 PM
Courtroom: 5
Judge: Hon. Edward M. Chen

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I. INTRODUCTION

The SRA Funds Investor Group (the "Investor Group") respectfully submits this brief in support of its proposed alternative distribution plan, which is being filed concurrently herewith. This is a *sui generis* receivership and securities fraud action in which, due to the rather unique nature of the assets held in the receivership estate and the recent completion of the claims process, it appears that notwithstanding the underlying misconduct by the defendants and relief defendants, all investors and creditors can still be made whole and the original investment objectives of the SRA Funds and SRA Fund investors can still be achieved. As it turns out, if Global Generation Group LLC ("Global") is found to be a creditor and the issue with EAC is resolved, there are no actual share shortfalls in **any** of the portfolio companies still held by the SRA Funds.[1] In fact, it appears that for eleven of the fourteen portfolio companies still held by the SRA Funds (including Palantir), there are actually share **surpluses**, many of which are substantial. For the other three portfolio companies, there are neither surpluses nor shortfalls.

The Investor Group's distribution plan recognizes the unique nature of this receivership and provides a plan that will allow all creditors to be made whole while at the same time allowing SRA Fund investors to achieve their original investment objectives. This is goal one would think everyone involved would support, particularly the SEC and the Receiver, who purport to be acting for the investors.

But, the SEC and the Receiver do not support the Investor Group's plan. Instead, they are once again proposing a plan that completely ignores the wishes of the investors and their investment

[1] As of the date of the filing of this brief, the Court has not yet ruled on the question of whether Global is a creditor or an investor. If Global is a creditor, there will be a Palantir share surplus, not a share shortfall. If Global is allowed to choose to be a Palantir investor, then there will be Palantir share shortfall, but that will be the only share shortfall and it will be in an amount that can be resolved by the Investor Group's proposed distribution plan without materially impacting the recoveries to SRA Funds investors and creditors.

objectives, ignores the unique nature of this particular receivership, and would treat this case like every other receivership case in which there are not sufficient assets to pay all claims – to the significant detriment of the very investors the SEC and the Receiver purport to represent. If there are sufficient assets and shares to pay all SRA Fund creditors and investors, as the Investor Group expects to be the case, there simply is no equitable basis for the Court to impose the *pro rata* distribution that the SEC claims is the only way for a distribution plan to go forward here. The Court should reject the SEC and the Receiver's plan, which is needlessly harmful to investors and ignores the facts of this case, and approve instead the Investor Group's distribution plan.

II. BACKGROUND

A. The Investor Group

The Investor Group represents more than 75% of the money still invested in the SRA Funds and includes more than 140 individuals and entities who purchased and continue to own membership interests in all seven of the SRA Funds. Members of the Investor Group collectively own shares in every company held in the investment portfolios of the seven SRA Funds. Each of the SRA Funds is a Delaware series limited liability company that sold membership interests to sophisticated, accredited investors pursuant to a confidential private placement memorandum, a limited liability company operating agreement, and a subscription agreement. The offering documents made clear to potential investors that investments in the SRA Funds were long-term and illiquid, with projected exits of between two and five years, and returns on investments, if any, taking even longer than that.

All SRA Fund investors (including all members of the Investor Group) are accredited investors, which means they either had annual income in excess of $200,000, a net worth of at least $1 million (excluding a primary residence) or were otherwise deemed to be a sophisticated investor at the time of their investments. Many of the members of the Investor Group are sophisticated investors with prior experience investing in non-publicly traded securities. Many are professionals, including partners in law firms, accountants, business executives, university professors, executives

in the financial sector, and partners in business consulting firms. For example, the members of the proposed advisory committee include two CPAs, a partner in a large multi-national law firm with private equity experience, a managing director of a global business consulting firm, and a managing director of an investment management firm (who is also a chartered financial analyst).

B. Relevant Procedural History

In June 2017, the SEC and the Receiver filed their original proposed joint plan of distribution, in which they advocated for the pre-IPO liquidation of all securities held by the SRA Funds and a *pro rata* distribution of funds to creditors and investors alike. *See* Dkt. No. 196. No SRA Funds investors supported the SEC and the Receiver's proposed distribution plan. In August 2017, the Investor Group, along with other interested parties, opposed the SEC and the Receiver's distribution plan and proposed an alternative distribution plan. *See* Dkt. No. 229. *See also* Dkt Nos. 226-227 (Telesoft objection and Global comments). At the September 2017 hearing on the competing plans, the Court did not approve either of the proposed original distribution plans and ultimately ordered all interested parties to work together on a number of receivership administration and distribution plan related issues. *See* Dkt. No. 256 (9/28/17 Minute Order).

In November 2017, the Court approved a Notice and Claim Form to be sent to potential creditors of and investors in the SRA Funds. *See* Dkt. No. 279. The Notice and Claim Form was sent out in December 2017, with a January 31, 2018 deadline for responding.

In December 2017, the Court approved the retention of Oxis Capital, an investment banking firm, to provide the Court with an independent opinion on the potential recoveries that the SRA Funds could expect to receive from the pre-IPO liquidation of the securities held by the SRA Funds, as advocated by the SEC and the Receiver, vs. holding those securities through to potential liquidity events, as advocated by the Investor Group. *See* Dkt. No. 281. The Oxis Capital Final Report was lodged with the Court on a confidential basis on February 2, 2018. In its report, Oxis recommended that the securities held by the SRA Funds not be sold until there were liquidity events and confirmed

that the pre-IPO liquidation of the SRA Funds portfolio likely would result in an exponentially smaller recovery by SRA Funds investors and creditors alike.

The SEC and the Receiver filed a motion to approve an amended proposed joint plan of distribution and a brief in support of that motion on March 15, 2018. *See* Dkt. Nos. 317-318. The Investor Group's response was due on March 22, 2018, with a hearing on April 5, 2018. *See* Dkt. No. 313. On March 21, 2018, however, before the Investor Group's response was due to be filed, the Court denied the SEC's and Receiver's motion without prejudice and vacated the April 5 hearing date because the claims process was not complete. *See* Dkt. No. 320.

In their June 15, 2018 Supplemental Status Report, the SEC and the Receiver updated the Court on the status of the claims process and provided the Court with a claim validation summary as of June 12, 2018 that is substantially complete, with the exception of a late claim filed by the Eliv Group. *See* Dkt. No. 342. The June 12, 2018 claim validation summary (in combination with other data) confirms that there are sufficient shares in all of the portfolio companies remaining in the SRA Funds to cover all SRA Funds investor claims and to satisfy creditor claims and other claims against the Receivership Estate if the Investor Group's distribution plan is adopted.[2]

C. The Current Status of the SRA Funds

The SRA Funds currently hold approximately $1.25 million in cash, which includes the remaining portion of the proceeds from the Receiver's $1.66 million sale of 97,505 Square shares[3] (after deducting fees and expenses awarded to the Receiver and its counsel), the clawback of

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[2] As noted above, this assumes that Global is a creditor, not a Palantir investor, that the EAC issue has been resolved, and that all forward contracts are honored.

[3] A number of SRA Funds investors who invested in Square shares received their share distributions in 2016 following the Square IPO and expiration of the lock-up and before the appointment of the Receiver in October 2016. Once the Receiver was appointed, the undistributed Square shares were sold rather than being distributed, so a number of other SRA Funds investors who invested in Square share have never received their share distributions. These investors will need to be compensated as a part of any distribution plan approved by the Court.

$120,010 from the misallocation of certain Square shares, and $500,000 from the disgorgement payment from relief defendant Anne Bivona.[4]

In addition to the cash held, the SRA Funds also currently hold securities for nine pre-IPO companies that remain in business and may have liquidity events in the future (Palantir, Uber, Addepar, Lockout, ZocDoc, Airbnb, Pinterest, Evernote, and Lyft), five companies that have undergone liquidity events but for which shares have not yet been sold or distributed (Snapchat, Mongo DB, Dropbox, Cloudera and Bloom Energy), and five companies that have either gone out of business or otherwise become worthless from an investment perspective (Practice Fusion, Jumio, Glam Media, Jawbone and Badgeville). Assuming that Global is deemed to be a creditor and that the EAC issue is resolved, **there are no share shortfalls** for any of the nine pre-IPO companies or any of the five post-IPO companies held by the SRA Funds.[5] In fact, there appear to be share surpluses for eight of the nine pre-IPO companies and three of the five post-IPO companies held by the SRA Funds.[6]

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[4] From March 2016 through the June 2018, Sherwood Partners (in its capacity as Monitor and then Receiver) and its counsel have billed a total of $1,162,354 to the SRA Funds. Only a portion of this amount has been paid to date.

[5] As noted above, if Global is allowed to choose to be treated as a Palantir investor, there will be a Palantir share shortfall. This shortfall can be made up, without affecting other investors, through the excess Palantir shares in the SRA Funds along with the use of shares representing management fees and back-end fees (if there are any). With respect to the EAC issue, the Investor Group understands that there is a spreadsheet that was used by EAC and the SRA Funds to track which entity owned what, and that this spreadsheet is uncontested by everyone involved, except for the SEC and the Receiver, who do not challenge the numbers, but claim instead that they cannot recreate certain transactions on the spreadsheet by tracing the flow of funds into and out of the SRA Funds. However, the SEC and the Receiver have acknowledged that if the spreadsheet is followed, there will be no share shortfalls in any of the SRA Funds, and there will be surpluses for some of the Funds. EAC has offered, in writing, to agree to follow the spreadsheet. The SEC and the Receiver have, to date, refused to do so.

[6] The share surpluses are as follows: Palantir – 177,981; Addepar – 74,345; Lookout – 7,601; ZocDoc – 25,950; Airbnb – 161; Pinterest – 74,119; Evernote – 7,822; Lyft – 1,521; Snapchat – 5,715; MongoDB – 9,299; Dropbox – 22,056.

The confidential report from Oxis Capital indicates that liquidity events for the nine pre-IPO companies held by the SRA Funds (in addition to the five companies that already have had liquidity events) could generate IPO proceeds that would be more than sufficient to pay all outstanding eligible claims against the Receivership Estate and still provide investors with a substantial return on their original investments.

For example, looking at just the five companies that already have had liquidity events, and taking into account just share surpluses and a conservative 8% in accrued management fees (but no potential back-end fees), at today's trading prices would result in cash proceeds of $2,205,610 to be used to satisfy administrative and creditor claims (in addition to the approximately $1.25 million in cash in the bank), and there would still be enough shares to fulfill all investor obligations according to their original investment agreements. If there is a Palantir liquidity event at the price suggested in the Oxis Capital confidential report, the Palantir share surplus, in combination with a conservative 8% in accrued management fees, would result in cash proceeds of $11,954,640, without even taking into account potential back-end fees, and still leave enough shares to fulfill all investor obligations according to their original investment agreements. Even if Palantir has a liquidity event at half the price suggested in the Oxis Capital Report, this would still generate almost $6 million in cash proceeds, which in addition to the cash already on hand and from the five other companies discussed above, would be more than sufficient to cover all administrative and creditor claims.

D. The Investor Group's Distribution Plan

The significant features of the Investor Group's proposed distribution plan are as follows:

1. The SRA Funds will continue to operate under an independent oversight officer and a new manager reporting to the Court, with the assistance of an advisory board of SRA Fund investors.

2. The Receivership will be dissolved and the Receiver dismissed.

3. Funds currently held by the Receivership Estate will be used immediately to pay certain claims.

4. No securities held by the SRA Funds will be sold until there are liquidity events and any lock-up periods have expired. Once shares may be sold, surplus shares and shares attributable to accrued management fees and back-end fees (if any are generated) will be sold to pay administrative and creditor claims and ongoing management expenses. All other shares will be distributed to investors in that particular portfolio company in accordance with their original investment objectives, subject to a 5% holdback to ensure that there are sufficient funds to pay all administrative and creditor claims and ongoing management expenses.

5. Once all claims and expenses have been paid in full, any remaining funds will be distributed to either investors in the particular portfolio companies whose liquidity events were profitable or to all investors who received share distributions, depending on the nature and amount of the remaining funds.

E. The SEC and the Receiver's Joint Plan of Distribution

In contrast to the Investor Group's proposed distribution plan, which strives to fulfill SRA Fund investor objectives while at the same time satisfying administrative and creditor claims, the SEC and the Receiver's latest distribution plan would still ignore the wishes of investors and immediately liquidate all shares once a liquidity event has occurred and the lock-up period has expired. The significant features of the SEC and the Receiver's latest distribution plan are as follows:

1. Investors and creditors will have the option of an early payment of their claims if they are willing to accept a substantial discount (70-75%). If any investors and creditors accept this early payment option, some of the pre-IPO shares held by the SRA Funds will be sold to cover the costs. An investment banker will be retained to sell the pre-IPO shares and then to monitor the SRA Funds portfolio on an ongoing basis.

2. While securities held by the SRA Funds will not otherwise be sold until there are liquidity events, once there are liquidity events and any lock-up periods have expired, all publicly-traded securities held by the SRA Funds will be sold by the Receiver and no shares will be actually be distributed to any SRA Funds investors.

3. All investors and creditors will be treated *pro rata* for distribution purposes based on original investment amounts (for investors) and debts owed (for creditors).

4. If there are sufficient funds, all investors and creditors will receive interest on the value of their claims until they are paid.

5. Investors in portfolio companies whose securities were sold by the Receiver for a profit may share *pro rata* in any funds remaining in the Receivership once all investors and creditors have otherwise been paid, but this may be reduced by paying additional funds to those investors and creditors who took the early payment option.

6. Investors who only purchased securities in a portfolio company that no longer has investment value will receive between 25-30% of the value of their original investments back, regardless of whether the portfolio company became worthless before or after the commencement of the Receivership, and regardless of the fact that there is no evidence (and none is even suggested) that any portfolio company became worthless as a result of any misconduct by a defendant, relief defendant or other Receivership entity.

7. The Receivership will continue until all shares have been liquidated and funds distributed to investors and creditors.

III. APPLICABLE LEGAL STANDARDS

The Court should exercise its authority to formulate a distribution plan that is consistent with the purposes of the receivership it is charged to oversee in this particular case.

The "primary purpose of equity receiverships is to promote the orderly and efficient administration of the estate by the district court for the benefit of creditors." *S.E.C. v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986). The Court's "power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad." *S.E.C. v. Capital Consultants, LLC*, 397 F.3d 733, 738 (9th Cir. 2005) (quoting *Hardy*, 803 F.2d at 1037)) (internal quotation marks omitted). "[T]he district court has broad powers and wide discretion to determine the appropriate relieve in an equity relationship." *Id* (quoting *S.E.C. v.*

Lincoln Thrift Ass'n, 577 F.2d 600, 606 (9th Cir. 1978)) (internal quotation marks omitted). "The basis for this broad deference… arises out of the fact that most receiverships involve multiple parties and complex transactions." *Id* (quoting *Hardy*, 803 F.2d at 1037).

The Court's broad, inherent supervisory power over the receivership also is necessary to enable it to "fashion [a] distribution plan that is fair and equitable to the investors." *S.E.C. v. Am. Capital Investments, Inc.*, 98 F.3d 1133, 1144 (9th Cir. 1996), *abrogated on other grounds by Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83 (1998) (quoting 2 Clark on Receivers § 482 (3d ed. 1992)); *see also Capital Consultants*, 397 F.3d at 738–739. Liquidation of a receivership estate for this purpose is an option of last resort, and any such proposed liquidation must be carefully scrutinized to ensure its fairness to investors.

In a prior ruling in this case, this Court has recognized that "[a] key threshold issue in determining the most equitable distribution plan will be whether the Receivership's Assets are adequate to satisfy the claims of all investors and creditors" and that "[t]he resolution of that dispute will likely play a significant role in fashioning the appropriate distribution plan here because the fundamental problem in many securities fraud cases arises when the assets available for distribution are insufficient to fully compensate all investors and creditors with legitimate claims." Sept. 13, 2017 Order at p. 10, Dkt. No. 246.

The Court went on to explain that "[i]f the available shares and/or funds are insufficient to fully compensate all investors" then the principle that "all victims of the fraud be treated equally" could require one of two possible distribution methods, either "the apportionment of available assets on a *pro rata* basis" method, or a mechanism to permit investors to "trace" their investments to discrete portions of the remaining assets. *Id*. at pp. 10-11. Without opining as to whether the Receivership assets were in fact adequate to satisfy all claims of investors and creditors in this case, the Court concluded its analysis by noting that the cases "do not require the court to adopt a particular distribution scheme. Rather, the Court must consider the situation as a whole, including how a

particular plan might affect similarly situated victims, to determine the most equitable distribution method." *Id.* at p. 13.

IV. THE SRA INVESTOR GROUP'S DISTRIBUTION PLAN SHOULD BE APPROVED

The Investor Group has proposed a distribution plan that recognizes the unique nature of this receivership and provides a plan that will allow all creditors to be made whole while at the same time allowing investors to achieve their original investment objectives. The Investor Group's distribution plan will replace the expensive and unwieldy Receivership with a less expensive independent oversight officer, which is all that is needed at this stage in the process. The Investor Group's distribution plan provides a mechanism to pay all administrative and creditor claims on a timely basis while at the same time ensuring that investors can still achieve their original investment objectives, which are to receive shares of the portfolio companies they invested in without any tax liabilities once there have been liquidity events and any lock-up periods have expired.

While the SEC will no doubt argue that the Investor Group's distribution plan should not be approved because there is evidence of commingling and therefore any distribution must treat all creditors and investors similarly and on a *pro rata* basis, this argument has no basis if, at the end of the day, there are sufficient funds to both pay all creditors and allow investors to achieve their original investment objectives. As this Court made clear in its September 13, 2017 Order, the principle that all victims of a fraud be treated equally only applies if there are insufficient funds to pay all claims. Because there are likely to be sufficient funds to pay all claims here (a fact supported by the opinion of an independent Court-appointed investment banker), the Court should decline to impose a *pro rata* distribution plan as proposed by the SEC and the Receiver that would unnecessarily harm investors, create an immediate tax liability for investors that would not otherwise exist, and that would deprive all investors of the possibility of achieving their original investment objectives.

In addition to being unnecessarily punitive to investors, the SEC and the Receiver's proposed distribution plan suffers from a number of other problems that should prevent the Court from approving that plan. First, it proposes to continue the Receivership for up to five additional years. The Receiver and its counsel already have billed almost $1.2 million dollars (a number certain to go up as it is only through June 2018), and there is no reason why investors and creditors should continue to bear the extraordinary expenses of the Receivership on a going forward basis. Second, this distribution plan would provide investors and creditors with an early payment option that no investor or creditor has requested and that is not provided for in any of the original offering documents.

The early payment option proposed by the SEC and the Receiver is dependent on the pre-IPO sale of a portion of the SRA Funds portfolio, which all investors object to. It is not even clear that a partial sale is possible, and even if possible, any such sale would be expensive for the SRA Funds because it would require the hiring of and payment to an investment banker. In addition to the ongoing expense of a continued Receivership, the SEC and the Receiver's distribution plan would add the ongoing expense of an investment banker simply to monitor the SRA Funds portfolio on a periodic basis. There is no basis for these kinds of additional costs to be imposed on SRA Funds investors on a going forward basis.

Finally, the SEC and the Receiver's distribution plan would pay a significant sum to those SRA Funds investors whose only investments were in portfolio companies that no longer have any investment value, regardless of when or how those companies lost value (the "rescission claims"). This would include companies that lost value prior to the commencement of the Receivership (a position not previously advocated by the SEC) and these claims would be paid (at 25-30% of the original investment amounts) even though for the companies that have lost value, there is no

evidence that there are any shares missing. On this record, there is no basis for these investors who made unfortunate investments to be paid anything.[7]

V. CONCLUSION

For all of the foregoing reasons, the Investor Group respectfully requests that the Court approve its proposed distribution plan and not approve the SEC and the Receiver's proposed joint plan of distribution.

Respectfully submitted,

DATED: September 28, 2018

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Attorneys for the SRA Funds Investor Group

[7] If the Court is inclined to award some rescission amounts to investors who made unfortunate investment decisions, any such award should be limited to the portfolio companies that lost value after the commencement of the Receivership and to 10% of the original investment amount to reflect the lack of merit of any potential rescission claim, none of which has been asserted by any investor to date.