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12 **UNITED STATES DISTRICT COURT**
13 **NORTHERN DISTRICT OF CALIFORNIA**
14 **SAN FRANCISCO DIVISION**

15 SECURITIES AND EXCHANGE
COMMISSION,

16 Plaintiff,

17 v.

18 JOHN V. BIVONA; SADDLE RIVER
19 ADVISORS, LLC; SRA
MANAGEMENT ASSOCIATES,
20 LLC; FRANK GREGORY
MAZZOLA,

21 Defendants, and

22 SRA I LLC; SRA II LLC; SRA III
23 LLC; FELIX INVESTMENTS, LLC;
MICHELE J. MAZZOLA; ANNE
24 BIVONA; CLEAR SAILING GROUP
IV LLC; CLEAR SAILING GROUP V
25 LLC,

26 Relief Defendants.
27
28

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

**RECEIVER’S REPLY TO OPPOSITION OF
JOSHUA CILANO TO PLAINTIFF
SECURITIES AND EXCHANGE
COMMISSION’S OBJECTIONS TO
RECEIVERSHIP CLAIMS BY MICHELE
MAZZOLA AND JOSHUA CILANO FOR
MANAGEMENT FEES**

Date: May 13, 2020
Time: 10:00 A.M.
Location: Courtroom 5, 17th Floor
450 Golden Gate Ave.
San Francisco, CA 94102
Judge: Edward M. Chen

Phelps Declaration filed concurrently

1 Kathy Bazoian Phelps ("Receiver"), Court-appointed permanent receiver for SRA
 2 Management Associates LLC, SRA I, LLC, SRA II, LLC, SRA III, LLC, Clear Sailing Group IV,
 3 LLC, Clear Sailing Group V, LLC, Felix Multi-Opportunity Fund I, LLC, Felix Multi-Opportunity
 4 Fund II, LLC, Felix Management Associates, LLC, NYPA Fund I, LLC, NYPA Fund II, LLC,
 5 NYPA Management Associates, LLC and Solis Associates Fund, LLC (collectively, the
 6 "Receivership Entities"), hereby files her Reply to the Opposition of Joshua Cilano (the "Cilano
 7 Opposition") to Plaintiff Securities and Exchange Commission's Objections to Receivership
 8 Claims by Michele Mazzola and Joshua Cilano for Management Fees [Doc. No. 572].

9 **I. The Receiver Has Not Reached Any Type of Settlement with Cilano**

10 The Cilano Opposition states at page 2, "After filing his claim, Mr. Cilano contacted the
 11 receiver and verbally negotiated a compromise of his backend fee claim, which limited his recovery
 12 to \$3.9 million as a subordinated claim." Contrary to this representation, the Receiver has never
 13 reached an agreement with Cilano regarding his claim and was startled to see that representation
 14 made in the Cilano Opposition. Declaration of Kathy Bozoian Phelps in Support of Receiver's
 15 Reply to Opposition of Joshua Cilano to Plaintiff Securities and Exchange Commission's
 16 Objections to Receivership Claims by Michele Mazzola and Joshua Cilano for Management Fees
 17 ("Phelps Decl."), at ¶ 3, filed concurrently herewith. The Receiver notes that the Declaration of
 18 Joshua Cilano omits any such statement or representation, so there is actually no evidence
 19 supporting the false statement in the Opposition as Cilano appears unwilling to include such a
 20 statement in a sworn declaration.¹

21 The facts and representations made in this proceeding regarding Cilano's claim tell a very
 22 different story:

- 23 1. At no point did the Receiver and Cilano reach an agreement regarding his claim for
 24 backend fees and commissions. No verbal or written agreement was reached with the
 25

26 ¹ The Receiver contacted counsel for Cilano upon reading the false statement regarding a supposed
 27 settlement of the Cilano claim in the Opposition, as well as the omission of that statement from the
 28 Cilano declaration. Although counsel insisted on the veracity of the statement in the Opposition,
 the Cilano Declaration has not been amended to include such a statement regarding a supposed
 settlement. Phelps Decl., ¶ 3.

1 Receiver. *See* Phelps Decl., ¶ 3. Additionally, no motion was filed with the Court
2 seeking approval of any kind of agreement with Cilano regarding his claim.

- 3 2. The Court specifically addressed Cilano’s claim at the June 27, 2019 hearing in this
4 case, stating that “based on everything I’ve seen, whether or not he was personally
5 culpable for some of the alleged misconduct, he did play a central role in the transaction
6 and the process.” Phelps Decl., ¶ 4, Exhibit “1” (June 27, 2019 Transcript at p. 32, lines
7 1-4.)
- 8 3. After discussion about Cilano’s claim at the hearing on June 27, 2019, the Court entered
9 a Minute Order finding: “The claim for backend fees asserted by Joshua Cilano is
10 DISALLOWED as it would be inequitable for Mr. Cilano to receive additional
11 compensation for his role in Defendants’ scheme at the expense of the investors, even if
12 Mr. Cilano was not personally culpable (Mr. Cilano may still recover on his personal
13 investor claim).” [ECF No. 503.]
- 14 4. Following the Court’s clear direction that Cilano’s claim for backend fees was to be
15 disallowed, the Receiver did not engage in any discussions with Cilano regarding
16 allowance of that claim, which would have been in contravention of the Court’s Order.
17 Phelps Decl., ¶ 5.
- 18 5. The versions of the Receiver’s Plan filed on December 16, 2020 [ECF No. 538]
19 specifically disallowed Cilano’s claim in the definition of Disallowed Claims.
- 20 6. At the hearing on January 30, 2020, the parties and the Court again discussed the
21 objectionable nature of Cilano’s claim for backend fees. The Court reiterated that the
22 claim for backend fees of Cilano was to be disallowed in the version of the Plan to be
23 circulated, stating “I want what’s going to be noticed to reflect that June order, and not a
24 change. If [Cilano] has an objection to that, he’ll have a due-process opportunity to do .
25 . . .” Phelps Decl., ¶ 6, Exhibit “2” (Transcript of January 30, 2020 hearing at p. 50, lines
26 6-9.) Cilano’s counsel of record² argued that Cilano was entitled to due process notice
27

28 ² Jonathan Levine and Elizabeth Pritzker state that they represent the SRA Funds Investor Group,

(footnote continued...)

1 of an objection to his claim, so clearly no “compromise” on the claim had been reached.

2 7. Following the January 30, 2020 hearing, the Receiver then had multiple
3 communications with Cilano’s then counsel of record about the objectionable nature of
4 Cilano’s claim, until his counsel stated that Cilano would be engaging new counsel to
5 deal with the claim objection issue. Cilano’s former counsel knew no “compromise” of
6 the claim had been reached. Phelps Decl., ¶ 7.

7 The Receiver has not previously agreed to any type of compromise or allowance of Joshua
8 Cilano’s claim. Phelps Decl., ¶ 3. The Plan does not allow for payment of management fees,
9 backend fees, or commissions. *See* Phelps Decl., ¶ 8; [ECF No. 570]. Cilano has declined to
10 include any statement in his declaration and swear to the assertion that some sort of compromise
11 has been reached as to his claim. Phelps Decl., ¶ 3. The representations about some type of
12 compromise regarding Cilano’s claim are false and misleading, to say the least.

13 **II. If Cilano’s Claim Were Allowed, the Plan Would Need to be Renegotiated**

14 The claim being asserted by Cilano is so large and so significant that it could seriously
15 change the equities of the case and the nature of distributions to be made under the Plan. The
16 parties have proceeded to negotiate the terms of the Plan based on the understanding that Cilano
17 would not be allowed an unsecured claim for backend fees, as is reflected in the Court’s June 27,
18 2019 Order. Phelps Decl., ¶ 8. The parties have carefully balanced the competing interests of the
19 different classes of claimants to strike the most equitable balance between the investors and
20 creditors. The allowance of a claim for Cilano would be akin to an elephant stepping on one side of
21 the scale.

22 The Cilano Opposition states that Cilano would agree to have the claim treated as a
23 subordinated claim, but such a statement is made without what appears to be an understanding of
24 the terms of the Plan. The Class 5 Subordinated Claims include a portion of Progresso’s claim and
25 all of the Investor Deficiency Claims. Cilano, in his “offer” to take a subordinated claim, is seeking

26 _____
(continued)

27 but no individual investor. However, the Investor Group is not a legal entity and the Notices of
28 Appearances filed by Pritzker Levine LLP reflect that the firm is appearing on behalf of the listed
individuals. [ECF Nos. 189, 193, and 548]

1 to share with unsecured creditors who hold legitimate claims but who have agreed to subordinate
2 their claims, and with the very Investors he says he wants to get paid first.

3 The Receiver suspects that both Progresso and some, if not all, of the Investors with
4 Allowed Claims could find Cilano's "offer" to take a \$2.9 million subordinated claim as
5 objectionable, and a major shift in the equities of the Plan which assumed that the Court meant
6 what it said in the June 27, 2019 Order – that Cilano's claim for backend fees is not allowed. *See*
7 Phelps Decl., ¶ 8.

8 Allowance of Cilano's claim would have an additional potentially inequitable result,
9 depending on whether the Court determines that adjustments are appropriate to accommodate the
10 SEC's request that Failed Investment Claims receive a distribution. The SEC proposes that any
11 surplus funds from the Plan Fund, the value tax losses generated in the Tax Holding Account, and
12 any surplus funds after all Classes have been paid in full, should be distributed to Failed Investment
13 Claims. If Cilano's claim is allowed, even as a subordinated claim, that will see Cilano paid ahead
14 of Failed Investment Claims and on equal footing with other subordinated claims, included Investor
15 Deficiency Claims.

16 Cilano's Opposition is not clear on what Cilano means by a "subordinated claim." Does
17 Cilano intend that Allowed Investor Claims and Failed Investment Claims are to be paid in full
18 before he receives any distribution?

19 **III. Cilano Has Admitted Luring Investors Into the Scheme and Should Not Be**
20 **Compensated for That**

21 The Cilano Declaration filed in support of the Cilano Objection makes clear Cilano's role in
22 bringing investors into the scheme. Cilano states: "I *guided* my clients to SRA Funds because they
23 were *the only way* to invest in Palantir Technologies Inc. and other sought-after Silicon Valley
24 investments." Cilano Decl., at ¶ 11 (emphasis added). Whether or not Cilano is an insider is not
25 even a necessary inquiry here. Cilano has admitted that he "guided" his clients into the fraudulent
26 scheme and that he knew that this was the "only way" his clients could buy "sought-after"
27 investments. Cilano's own declaration reveals that he knew this investment must be too good to be
28 true if it was the only way to invest in these securities. The red flags were visible to him, yet he

1 guided unsuspecting clients, who were presumably relying on him to conduct due diligence, into
2 the scheme. Had Cilano actually been paid these fees and commissions that he is now requesting,
3 the Receiver might actually have sought to recover them as fraudulent transfers. There is ample
4 authority supporting the avoidance of commission payments to brokers who lure investors into a
5 fraudulent scheme, particularly where they were on notice of red flags. *See e.g., Warfield v. Byron*,
6 436 F.3d 551, 560 (5th Cir. 2006) (“It takes cheek to contend that in exchange for the payments he
7 received, the [debtor’s] Ponzi scheme benefitted from his efforts to extend the fraud by securing
8 new investments”); *see also Steed Hawkins (In re Rivas)*, 2012 Bankr Lexis 1482, at *17, n.6
9 (Bankr E.D. Tenn., Apr. 6, 2012) (citing cases).

10 The Receiver is advised that Cilano has already received commissions of about \$675,000 in
11 connection with his efforts to “guide” investors into this scheme. See Declaration of Monica Ip,
12 [ECF No. 239]. The Receiver does not believe that payment of any additional fees or commissions
13 is appropriate as a matter of equity. Phelps Decl., ¶ 9.

14
15 WHEREFORE, the Receiver requests that the SEC’s Objection to Cilano’s claim for
16 backend fees and commissions (joined by the Receiver) be sustained, and all other appropriate
17 relief.

18
19 Date: April 1, 2020

/s/ Kathy Bazoian Phelps
Kathy Bazoian Phelps, Successor Receiver