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 10 **UNITED STATES DISTRICT COURT**
 11 **NORTHERN DISTRICT OF CALIFORNIA**
 12 **SAN FRANCISCO DIVISION**

13 SECURITIES AND EXCHANGE
14 COMMISSION,

15 Plaintiff,

16 vs.

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

19 Defendants, and

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

23 Relief Defendants.

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

**THE SRA FUNDS INVESTOR
 GROUP'S RESPONSE TO THE
 SUCCESSOR RECEIVER'S
 PROPOSED PLAN OF
 DISTRIBUTION (ECF NOS. 487-488)**

Date: June 27, 2019

Time: 1:30 PM

Courtroom: 5

Judge: Hon. Edward M. Chen

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 28 **THE SRA FUNDS INVESTOR GROUP'S RESPONSE TO THE SUCCESOR
 RECEIVER'S PROPOSED PLAN OF DISTRIBUTION (ECF NOS. 487-488)**

INTRODUCTION

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2 The SRA Funds Investor Group (“Investor Group”) respectfully submits this response to the
3 Successor Receiver’s Proposed Plan of Distribution (“Distribution Plan”) (ECF 487) and comments
4 regarding that Plan (ECF 488). The Investor Group has worked with Ms. Phelps, the Successor
5 Receiver, over the past few months on a revised distribution plan. The Distribution Plan that is now
6 before the Court for consideration reflects the outcome of those efforts. For the most part, the
7 Investor Group supports the Distribution Plan, with several important caveats, which are discussed
8 below. The Investor Group also does not believe that Ms. Phelps, who is admittedly new to this
9 litigation, has accurately characterized some of the facts in her comments; therefore, the Investor
10 Group responds to Ms. Phelps’s comments, as appropriate, to correct or clarify the record. For the
11 reasons set forth below, the Investor Group respectfully requests that any distribution plan
12 ultimately adopted by the Court incorporate the changes and comments set forth below.

THE INVESTOR GROUP’S PROPOSED CHANGES TO THE DISTRIBUTION PLAN

14 The Distribution Plan proposed by Ms. Phelps is, for the most part, an acceptable
15 compromise for the Investor Group as long as the following changes to that Plan are implemented
16 before the Plan receives final approval. First, the manner in which the Investor Advisory Committee
17 (“IAC”) is appointed, is not acceptable to the Investor Group and not consistent with that portion
18 of the Investor Group’s alternative distribution plan that the Court has previously indicated it would
19 adopt and, indeed, it changed from all of the drafts circulated among the parties before the Plan was
20 filed with the Court. The Investor Group desires that this appointment process revert to the process
21 previously approved by the Court. Second, the \$500,000 in disgorgement funds received from relief
22 defendant Anne Bivona should be made part of the assets of the Receivership Estate and used to
23 satisfy non-investor claims. Third, the tax treatment and apportionment of tax liability is the subject
24 of ongoing discussions, both with the Receiver and with tax professionals, based on information
25 only recently provided by the Receiver. This aspect of the Plan should be discussed further and
26 additional changes may need to be made once the tax professionals have had an opportunity to

1 provide comments. The Investor Group addresses each of these issues in more detail below.

2 **1. The Investment Advisory Committee**

3 The Investor Group's alternative distribution plan proposed the appointment of an IAC by
4 the Court and identified the proposed members of that Committee. *See* ECF 407-1 at pp. 4-5. The
5 Court has previously indicated that this part of the Investor Group's plan would be adopted in any
6 final plan approved by the Court. In the drafts of the Distribution Plan circulated by the Receiver
7 among the interested parties, including to the Investor Group, the drafts all included this language
8 from the Investor Group's plan appointing specifically named individuals to the IAC. However,
9 the version ultimately filed by the Receiver (ECF 487) sets forth an entirely different process for
10 the appointment of the IAC, one that gives the appointment authority to the Receiver, not the Court,
11 and that allows input from both the SEC and Progresso Ventures, which this Court has already held
12 is a creditor, not an investor.

13 The Investor Group objects to this change in the Distribution Plan as it pertains to the
14 appointment of the IAC. The purpose of the IAC is to be an independent voice for the investors
15 and it is the investors who should decide, subject to Court approval, who the members of the IAC
16 will be. Neither the Receiver, the SEC, nor Progresso Ventures should have any say in that process,
17 particularly since the IAC, as now proposed, serves in only an advisory capacity. The Receiver
18 should not have the unilateral authority to decide which investors will be watching over her and the
19 SEC as the Distribution Plan is implemented. For these reasons, the Court should appoint the
20 investors identified in ECF 407-1 as the members of the IAC.

21 **2. The Anne Bivona Disgorgement Funds**

22 The SEC obtained \$500,000 in disgorgement funds from relief defendant Anne Bivona.
23 Despite more than one year of filings by the SEC relating to the distribution plan, it continues to
24 refuse to say whether these funds will be kept by the SEC to be used for its own purposes or made
25 a part of the Receivership Estate. The Receiver takes no position on this in her Distribution Plan.
26 *See* Distribution Plan at p. 16. The Investor Group believes that these funds should be made part

1 of the Receivership Estate and used to pay non-investor claims. First, Ms. Bivona presumably
2 surrendered these funds because they were traceable in some manner to the misconduct by
3 defendants that caused harm to the investors and other creditors of the SRA Funds. These funds
4 thus should be used to compensate those victims, not the SEC. Second, the SEC has unnecessarily
5 prolonged and significantly increased the expense of this Receivership through its conduct over the
6 past year, and the disgorgement funds will help to offset the significant (and often unnecessary)
7 receivership expenses that have resulted from that. For these reasons, the Court should order that
8 all of the disgorgement funds received from Ms. Bivona be made a part of the assets of the
9 Receivership Estate.

10 3. Tax Treatment and Apportionment of Tax Liability

11 This Receivership has now been pending for more than two years. Apparently, at no time
12 did either the SEC or the former receiver ever consider or seek a professional opinion on the tax
13 implications to investors of the filing of the Receivership on those investors. Following her
14 appointment as successor Receiver, Ms. Phelps finally did seek such advice, and the tax opinion
15 provided, if correct, may have a significantly negative impact on investors by creating multiple
16 taxable events where none previously would have existed. That this fact was neither known to the
17 SEC and the former receiver nor ever disclosed to the investors in the more than 18 months of
18 discussions over the implementation of a distribution plan is, frankly, shocking, particularly given
19 the extraordinary amount of money billed by the former receiver for its work in this matter.

20 According to the tax opinion given to Ms. Phelps, the distribution of shares to investors will
21 constitute a taxable event for investors. This outcome was predetermined as soon as the
22 Receivership was commenced in 2016. This is vastly different from what would have happened had
23 the SRA Funds been allowed to continue operating. Absent the Receivership, the distribution of
24 shares to investors following a successful liquidity event would not be a taxable event, and investors
25 would only be taxed, if at all, when those shares were sold. Now, according to Ms. Phelps, investors
26 will be taxed when they receive their shares. This may have significant financial implications for

1 investors, who are seeking their own professional opinion as to whether the opinion received by
2 Ms. Phelps is correct. Based on the advice to be provided, the Investor Group may propose further
3 modifications to the Distribution Plan before it is finally approved by the Court.

4 **THE INVESTOR GROUP'S RESPONSE TO THE RECEIVER'S COMMENTS**

5 In addition to the Distribution Plan, Ms. Phelps also filed separate comments regarding the
6 certain aspects of the Plan. *See* ECF 488. The Investor Group responds below to some of Ms.
7 Phelps' comments in order to correct or clarify the record.

8 Ms. Phelps states in her comments that the Investor Group's proposed plan is not feasible
9 because it did not provide for the payment of taxes and did not set aside enough money to pay non-
10 investor claims. The Investor Group disagrees with Ms. Phelps' statements in this regard. First,
11 the Investor Group's plan did in fact provide for the payment of taxes as a priority claim, just as her
12 Distribution Plan does. While not as clearly stated as in the Distribution Plan, the Investor Group's
13 plan contemplated that taxes would be paid as an administrative claim first. *See* ECF 407-1 at p. 1,
14 fn. 1. Second, the Investor Group continues to believe that its plan would have generated enough
15 cash to pay all non-investor claims. The Investor Group notes, in this regard, that if Ms. Phelps
16 resolves her dispute with EAC Corp., there will either be surpluses or sufficient shares to cover all
17 investor claims with the exception of Palantir, for which there is now a relatively modest shortfall
18 that has only come about as a result of the late claims process Ms. Phelps requested.

19 While the Distribution Plan itself contemplates that unsecured creditors will be paid pro rata
20 over time, just as investors will be paid in shares pro rata over time, in her comments, Ms. Phelps
21 raises an issue with respect to this proposal and notes that certain creditors are now taking the
22 position that they are entitled to be paid in full before any investors receive any share distributions.
23 The Investor Group believes that this position is contrary to the record and contrary to the Court's
24 prior rulings and statements about the distribution plan. The Court has previously indicated that it
25 intended to adopt the core features of the Investor Group's plan, which has always contemplated
26 that unsecured creditors will be paid over time as liquidity events occur. While the Investor Group
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1 has always taken the position that it believes that unsecured creditors will ultimately be paid in full,
2 it has never been the position of the Investor Group that all unsecured creditors would be paid in
3 full before investors started to receive their shares.

4 To be clear, the Investor Group objects to any changes to the Distribution Plan that would
5 provide for unsecured creditors to be paid in full prior to any investor distributions occurring. Such
6 a change would be inconsistent with the portion of the Investor Group's plan that the Court has
7 previously stated that it would adopt.

8 Ms. Phelps notes in her comments that there is a disagreement between the SEC and the
9 Investor Group as to whether Mr. Cilano is an insider. There is no such disagreement. The SEC
10 has never alleged that Mr. Cilano is an insider, has never sought to exclude his claim on the basis
11 of insider status and has never taken any formal or informal action against Mr. Cilano in any manner
12 related to this case. To be clear, again, Mr. Cilano is not and never was an insider and it is long
13 past time for the SEC to stop suggesting otherwise.

14 Finally, Ms. Phelps seeks authorization from the Court to commence as many as four or
15 more different lawsuits. No such authorization should be granted by the Court unless Ms. Phelps
16 justifies the basis for each such lawsuit, provides a budget for each lawsuit, demonstrates
17 collectability to justify the effort, and provides an estimate of what she expects to recover. Far too
18 much money has been wasted already in this Receivership. While Ms. Phelps certainly should
19 pursue litigation if necessary and economically viable, no such showing has been made to justify
20 granting her blanket authorization to commence multiple lawsuits on behalf of the Receivership.

21 **CONCLUSION**

22 For all of the foregoing reasons, the Investor Group respectfully requests that the Court
23 incorporate into any approved Distribution Plan the changes and comments set forth above.

24 Respectfully submitted,
25 DATED: June 20, 2019 PRITZKER LEVINE LLP
26 By: /s/ Elizabeth C. Pritzker
27 Elizabeth C. Pritzker

Jonathan K. Levine
Bethany Caracuzzo

Attorneys for the SRA Funds Investor Group

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