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5 *Successor Receiver*

6 **UNITED STATES DISTRICT COURT**
7 **NORTHERN DISTRICT OF CALIFORNIA**
8 **SAN FRANCISCO DIVISION**

10 SECURITIES AND EXCHANGE
COMMISSION,

11 Plaintiff,

12 v.

13 JOHN V. BIVONA; SADDLE RIVER
14 ADVISORS, LLC; SRA
MANAGEMENT ASSOCIATES,
15 LLC; FRANK GREGORY
MAZZOLA,

16 Defendants, and

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

21 Relief Defendants.

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

**MOTION BY RECEIVER KATHY
BAZOIAN PHELPS TO:**

- (1) **EMPLOY MILLER KAPLAN AS TAX
ADVISOR**
- (2) **EMPLOY SCHINNER & SHAIN LLP
AS SECURITIES COUNSEL; AND**
- (3) **FOR INSTRUCTIONS**

Hearing Date: September 12, 2019

Time: 10:30 a.m.

Location: Courtroom 5, 17th Floor
450 Golden Gate Ave.
San Francisco, CA 94102

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1 Kathy Bazoian Phelps, the successor receiver herein (the “Receiver”), hereby files this
2 Motion to (1) Employ Miller Kaplan as Tax Advisors; (2) Employ Schinner & Shain as Securities
3 Counsel; and (3) for Instructions. The Receiver has conferred with counsel for the Securities and
4 Exchange Commission, who as advised that the SEC does not oppose the Motion. The Receiver
5 has also conferred with counsel for the SRA Investor Group who advised that they wish to
6 consider the matter further before responding as to their position.

7 **I. INTRODUCTION**

8 The Receiver proposed a Distribution Plan and, at the last hearing, concerns were raised
9 regarding the tax consequences of the Plan. The Court requested that the Receiver obtain a tax
10 opinion that she could share with the SRA Investor Group regarding the anticipated tax
11 consequences of the Plan. Following the hearing, the SEC recommended that the Receiver retain
12 securities counsel to ensure that the anticipated sale and transfer of securities under the Plan were
13 compliant with, or exempt from, securities regulations.

14 The Receiver has identified Miller Kaplan as a tax advisor to render the tax opinion, and
15 she has identified Schinner & Shain LLP to render a securities opinion. This Motion seeks
16 authority to employ both of those professionals to advise the Receiver in connection with the
17 Plan.

18 Additionally, however, through discussion with Miller Kaplan, the Receiver has learned
19 that there may alternative approaches to address the tax issues. The Receiver seeks instructions by
20 this Motion as to whether to incur additional expenses and delay to pursue an alternative approach
21 to the taxes which may or may not be approved by the IRS and which will have an unknown
22 impact on the net tax liability. As set forth below, while it is the Receiver’s inclination not to
23 pursue this alternative plan regarding tax treatment, the Receiver feels it is appropriate that the
24 Court and interested parties have an opportunity to review the matter before a final decision is
25 made.

26 In summary, there are two principal approaches to handling the tax issues:

27 (1) Scenario 1 is to treat both IPO Shares and Pre-IPO Shares, as those terms are defined
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1 below, as part of the qualified settlement fund (“QSF”), which is the lower risk, lower cost option
2 contemplated in the Plan, but could result in potentially higher taxes; or

3 (2) Scenario 2 is to try to obtain an IRS ruling that the Pre-IPO Shares are not part of the
4 QSF, which will be higher cost, could result in delays and logistical transfer issues, but could
5 potentially result in lower taxes.

6 By this Motion, the Receiver seeks instructions from the Court as to whether to pursue
7 Scenario 1 or 2, and for authority to employ Miller Kaplan to provide tax advice, opinions and
8 services for whichever approach the Court deems appropriate and to employ Schinner & Shain to
9 provide securities advice on both Scenarios as well.

10 **II. STATEMENT OF FACTS**

11 1. Pursuant to the Revised Order Appointing Receiver entered on February 28, 2019
12 (the “Receiver Order”), the Receiver is authorized to employ professionals.

13 2. The Receiver’s Plan contemplates that all of the securities that will be sold or
14 liquidated pursuant to the terms of the proposed Plan are part of a QSF that was established when
15 the receivership was formed on October 11, 2016.

16 3. Some of the securities are currently publicly traded (the “IPO Shares”) and other
17 securities are pre-IPO with the estate owed the right to securities pursuant to forward contracts or
18 holding stock certificates in private companies (“Pre-IPO Shares”). Both the IPO Shares and the
19 Pre-IPO Shares (collectively, the “Shares”) were obtained by the Receivership Entities on a pre-
20 IPO basis pursuant to forward contracts and purchases from insiders or employees holding an
21 interest in pre-IPO shares. The IPO Shares are held in the Receiver’s brokerage account.

22 4. The Receiver is aware of authority that all assets of a receivership are deemed to
23 be part of a QSF (Scenario 1); however, an issue has been raised as to whether the Receiver could
24 assert that the Pre-IPO shares might be excluded from the QSF if they could be distributed
25 directly from the transferor to the investors or through a trust that the Receiver could set up
26 (Scenario 2). As set forth below, there are costs, delays, and logistical issues to be considered in
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1 connection with Scenario 2, and the tax benefit is and will remain unknown due to the uncertain
2 value of the Shares when they are ultimately sold.

3 5. The Investor Group questioned why there would be any tax liability for investors
4 receiving a distribution of shares from the Receiver and requested a tax opinion. The Court and
5 the Receiver agreed that obtaining a tax opinion setting forth the law and manner of calculation of
6 taxes would be appropriate. The Receiver has selected Miller Kaplan as her tax advisor and
7 requests authority to employ the firm. The terms of the engagement and the qualifications of the
8 firm are set forth in Exhibits “1” and “2” attached to the Declaration of Kathy Bazoian Phelps.

9 6. Additionally, the SEC has recommended that the Receiver retain securities counsel
10 to assist the Receiver in connection with the sale and distribution of shares. Both the Pre-IPO
11 Shares and the IPO Shares held by the Receiver have never been registered for offer or sale, and
12 an opinion from securities counsel would be advisable before the Receiver attempts to sell or
13 distribute the Shares. The Receiver seeks to employ Schinner & Shain for this purpose. The
14 qualifications of the firm and the proposal are set forth in Exhibit “3” attached to the Declaration
15 of Kathy Bazoian Phelps.

16 **III. SUBSTANCE OF PROPOSED TAX ADVISORY SERVICES**

17 The Receiver is advised that the following tax consequences could flow from a
18 distribution plan involving the sale and distribution of securities, and the following explanation of
19 the tax consequences is set forth in the Plan:

- 20 a. The Receivership Estate is treated as a Qualified Settlement Fund (“QSF”) effective as
21 of the date of the commencement of the Receivership Estate, October 11, 2016.
22 b. The assets of the Receivership Entities became property of the QSF as of October 11,
23 2016.
24 c. In order to establish the tax basis in the assets of the QSF, the Receiver will need to
25 obtain a valuation of the assets of the Receivership Entities as of October 11, 2016.
26 d. The sale of securities and the distribution of securities are taxable events.

- e. The QSF will be taxed on the difference between the value as of the commencement of the receivership and the date of sale or distribution as ordinary income, which is estimated to be 40% of the gain.
- f. There may be deductions available to offset some or all of the gain, but such amounts or the ultimate impact on tax liability is presently unknown.
- g. Any tax liability of the estate will have to be paid through the sale of securities to generate sufficient cash to pay such tax liability.
- h. The Receiver will be unable to make distributions to creditors or investors until such time as the Receiver determines that sufficient funds are available to pay all taxes in full. Otherwise, the Receiver could be personally liable for any unpaid tax claims. *See* 31 U.S.C. § 3713.¹

The SRA Investor Group requested a formal tax opinion confirming the above tax consequences. The Receiver has preliminarily consulted with a tax advisor and they have together explored possible alternatives in an effort to mitigate tax liability. Whether the IRS and Franchise Tax Board would approve of another tax treatment is uncertain, and a formal ruling from the taxing agencies would be required before the Receiver would consider a different tax treatment.

¹ **31 U.S.C. § 3713**

(a)

(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

- (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
- (ii) property of the debtor, if absent, is attached; or
- (iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

1 Accordingly, the Receiver seeks instructions from the Court as to whether to engage the tax
2 advisor to write the opinion originally contemplated by the parties and the Court, or to explore
3 other possible alternatives and a ruling from the IRS confirming other tax treatment. These two
4 different approaches are discussed in more detail as follows.

5 **A. The Two Possible Scenarios**

6 The principal issues to be addressed are: (1) whether and how the sale and distribution of
7 the IPO Shares are to be taxed if deemed to be part of the QSF (Scenario 1); and (2) whether it is
8 appropriate to try to exclude the Pre-IPO Shares from the QSF in an attempt to mitigate tax
9 liability (Scenario 2).

10 (1) Scenario 1: The decision in *United States v. Brown*, 348 F.3d 1200 (10th Cir. 2003),
11 establishes that assets of a receivership estate are deemed to be transferred to a QSF as of the date
12 of the commencement of the receivership. The Receiver is advised that the IRS largely defers to
13 this opinion. The IPO Shares are in the Receiver's brokerage account and appear to be part of the
14 QSF. The Receiver is advised that the sale or distribution of those securities will be taxable events
15 at the QSF level. The QSF would pay tax on any "gain" realized at the time of sale or distribution.
16 The QSF is not entitled to capital gains treatment. The SRA Investor Group has requested a
17 written tax opinion setting forth that analysis in writing. This Motion requests, in part, approval of
18 the Receiver's employment of a certified public accounting firm with expertise on this issue to
19 render that opinion. At a minimum, the IPO Shares are deemed part of the QSF, and Miller
20 Kaplan does not recommend taking another position with respect to the IPO Shares. The tax
21 opinion would set forth the tax consequences of treating all of the Shares as part of the QSF. The
22 question of how to treat the Pre-IPO Shares is set forth in Scenario 2.

23 (2) Scenario 2: On the second issue of whether the Pre-IPO Shares can somehow be
24 excluded from the QSF, the Receiver seeks instructions from the Court on how to proceed. As
25 originally contemplated, the Receiver could obtain a tax opinion that the Pre-IPO Shares are part
26 of the QSF and are taxed accordingly (Scenario 1). However, a simple tax opinion that the Pre-

1 IPO Shares are *not* part of the QSF will not protect the Receiver from potential liability if the IRS
2 disagrees. The Receiver is subject to personal liability if such a tax opinion is not accepted by the
3 IRS, so the Receiver cannot proceed on the basis of a tax opinion alone. Accordingly, Scenario 2
4 requires a ruling from the IRS that such an approach is acceptable to the IRS, as set forth in more
5 detail below.

6 Miller Kaplan has agreed to provide its services at the same hourly rates as those provided
7 to SEC fair funds in which Miller Kaplan is appointed as the tax administrator. These discounted
8 SEC rates are less than Miller Kaplan's normal rates as set forth in more detail in its engagement
9 letter attached to the Phelps Declaration as Exhibit "1." The qualifications of Miller Kaplan to
10 render an opinion under Scenario 1, or to seek an IRS Ruling under Scenario 2, are set forth in
11 detail in the Phelps Declaration and Exhibit "2" attached thereto

12 **B. Costs and Risks of Different Approaches**

13 A ruling from the IRS may be possible but will be costly, time-consuming, and might not
14 lead to agreement by the IRS that the Pre-IPO Shares are excluded from the QSF. There are also
15 potential logistical issues. The essential questions to be answered are:

16 (1) Are both IPO Shares and Pre-IPO Shares property of the QSF or can the Pre-IPO
17 Shares be distributed outside the QSF? Or, if the Pre-IPO shares are transferred directly from the
18 current owner to the investors, do the US Treasury Regulations regarding the receipt and
19 disposition of securities by a QSF prevent the distribution of the securities outside of the QSF?

20 (2) What are the tax reporting and withholding obligations of the Receivership QSF
21 and the Receiver in these two scenarios (i.e., if either all Shares are deemed a part of the QSF, or
22 just IPO Shares are in the QSF)?

23 (3) Are there potential securities issues or violations that might arise under either
24 scenario? The SEC has recommended that the Receiver obtain a securities opinion regarding the
25 sale or disposition of securities irrespective of whether the securities are part of the QSF or not.

26 The costs and risks associated with the different scenarios, and the possible resulting tax
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1 consequences, are discussed as follows:

2 Scenario 1: The most safe and conservative approach is to treat all of the securities, both
3 IPO Shares and Pre-IPO Shares, as part of the QSF. The IRS would not likely dispute this
4 position and the Receiver can obtain a tax opinion describing the tax treatment of the sale or
5 transfer of these securities. The tax treatment from this approach could result in the greatest
6 potential tax liability. However, deductions from returns to be filed for the QSF for the years 2016
7 – 2019 could mitigate the tax liability. Additionally, because the value of the shares at the time of
8 sale or distribution is unknown, the economic impact of proceeding under Scenario 1 cannot
9 presently be calculated.² The cost of the tax opinion for Scenario 1 is estimated to be between
10 \$25,000 and \$45,000, as set forth in Exhibit “1.” This is the Receiver’s recommended approach.

11 Scenario 2: A greater cost approach is to treat the IPO Shares as part of the QSF, but to
12 seek a ruling from the IRS that the Pre-IPO shares are not part of the QSF. The IRS might not
13 agree and could find that all assets, even if a right under a forward contract, are part of the QSF
14 and should be taxed as a sale at the QSF level upon sale or distribution. The Receiver could seek
15 an opinion from the IRS in advance of taking this position in the form of a Closing Agreement or
16 Private Letter Ruling (PLR) to attempt to gain certainty and protection from tax, penalties or
17 interest. The professional fees for seeking a Closing Agreement or PLR would be toward the
18 higher range of \$65,000. The IRS also charges a user fee of \$30,000 for the Closing Agreement or
19 PLR. The ruling is discretionary and the IRS may choose not to rule. The typical amount of time
20 from request to final ruling is 12 to 18 months, although expedited processing may be requested
21 and a ruling in six (6) months might be possible. An additional challenge is that even if the Pre-
22 IPO Shares are not deemed part of the QSF, the logistics of arranging for a transfer agent to sell
23 and distribute shares pursuant to complex calculations under the Plan could lend itself to high

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25 ² The Receiver anticipates engaging a valuation expert to establish the tax basis in the Shares as of
26 October 11, 2016, which will be one-half of the equation necessary to calculate tax liability. The
27 gain cannot yet be calculated, however, so the Receiver will wait to engage a valuation expert until
the Court determines whether the Receiver should proceed under Scenario 1 or 2.

1 costs and possible mistakes.

2 **IV. SUBSTANCE OF PROPOSED SECURITIES COUNSEL SERVICES**

3 Schinner & Shain will be preparing what are essentially two forms of opinions of counsel.
4 One will address whether shares that the Receiver is to sell pursuant to the Plan through her
5 broker-dealer at Wells Fargo Advisors may be sold without registration under the Securities Act
6 of 1933 (the “Act”). The second opinion is whether other shares may be distributed to claimants
7 under the Plan without registration under the Securities Act and, if so, whether those shares will
8 need to bear a restrictive legend.

9 Schinner & Shain will prepare a group of letters to be provided to the broker-dealers who
10 will be selling the shares and a second group of letters will be given to the transferees, the
11 companies that issued the shares, or both. These types of letters are not typically provided to the
12 Securities and Exchange Commission, but copies can be provided to the SEC or a separate
13 opinion letter can be issued to the SEC if requested or necessary.

14 The services to be performed will entail a review of the circumstances relating to the
15 shares to be sold or distributed and a review the forward purchase contracts pursuant to which the
16 defendants in this case acquired the shares, as the general terms of these agreements will be
17 important in establishing whether the safe harbor to registration in SEC Rule 144 is available for
18 these sales and transfers.

19 The securities advice sought by the Receiver will not impact the analysis for either
20 Scenario 1 or 2. The Receiver is advised that she should be able to sell or distribute the shares
21 after applicable lockup periods whether the Receiver proceeds under Scenario 1 or 2 provided that
22 the appropriate opinion letters can be prepared and delivered.

23 The securities counsel estimates that its services will be \$10,000 to \$20,000, and the firm
24 has agreed to a public service discount of 10% off its regular rates as set forth in detail in its
25 engagement letter attached to the Phelps Declaration as Exhibit “3.” The qualifications of
26 Schinner & Shain to render these opinions and issue these letters is set forth in detail in Exhibit A

1 to the engagement letter.

2 **V. REQUEST FOR INSTRUCTIONS**

3 The Receiver requests instructions from the Court as to whether to incur the additional
4 costs and time delays in seeking a ruling from the IRS to exclude the Pre-IPO Shares from the
5 QSF as described in Scenario 2 above. The Receiver's concerns with the approach set forth in
6 Scenario 2 are as follows:

- 7 1. The Receiver believes that the outcome of such a request to the IRS is, at best,
8 uncertain, and that the IRS may likely either decline to rule or may determine that an
9 effort to keep the Pre-IPO shares out of the QSF is not permissible.
- 10 2. There will be additional fees incurred in the process of attempting to obtain an IRS
11 Ruling.
- 12 3. The IRS will charge a \$30,000 fee for the request for a ruling. Although the Receiver
13 could withdraw the request for a ruling if the outcome does not appear promising
14 following a preliminary determination, the Receiver will have already spent these
15 increased fees in seeking the ruling.
- 16 4. The time horizon to get a full IRS ruling could be 12 to 18 months. Although an
17 expedited request can be made, it is not guaranteed, and the Receiver is advised that an
18 expedited request would like still take at least 6 months.
- 19 5. Approval of a Plan in this case is now contingent upon getting a tax opinion. While a
20 tax opinion confirming the structure set forth in the Plan can be obtained relatively
21 quickly, the delay from seeking a tax ruling would significantly delay approval of the
22 Plan and distribution to the creditors and investors.
- 23 6. The Receiver is already holding shares in 5 companies that are IPO Shares and nearly
24 ready for distribution upon Court approval of the Plan. An 18-month delay will delay
25 distribution of those IPO Shares. The Receiver cannot guarantee the strength of the
26 stock market in the meantime, and all parties will be bearing some risk in a significant
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1 time delay.

- 2 7. The structure proposed in Scenario 2 would involve the sale and distribution of the
3 Pre-IPO Shares (after there is a liquidity event and all lock up periods are expired) by
4 a transfer agent. The Receiver believes that there will be extra costs incurred in
5 providing complex instructions and in monitoring a transfer agent to sell the
6 appropriate amount of shares as calculated under the Plan and in distributing the shares
7 to numerous investors entitled to a return of shares under the Plan.
- 8 8. The ultimate tax benefit from proceeding under Scenario 2 as opposed to Scenario 1 is
9 presently unknown. There are a few variables that will not be known until the time of
10 sale or distribution which will impact the tax liability under Scenario 1. First, the
11 Receiver will need to file QSF returns for the stub year in 2016 and for each year since
12 then, and the tax loss generated from those returns is presently unknown but should
13 serve as a credit against any taxes that may be owed from the sale and distribution of
14 Shares from the QSF. Second, the tax liability will be calculated based upon the price
15 of the Shares at the time of sale or distribution, which is presently unknown. Third, the
16 tax liability will also be based upon the tax basis in the Shares, which is tied to the
17 value as of October 11, 2016, which is presently unknown.³ Fourth, some of the
18 Shares might not reflect any gain from the tax basis figure through the date of sale
19 figure, so no tax liability might even be generated at all in some circumstances. In
20 other words, although tax liability for the estate might be mitigated or largely
21 eliminated under Scenario 2, the size of the tax liability under Scenario 1 is unknown
22 at this time.

23 Because of the costs, delays, risks and unknowns, the Receiver prefers and recommends
24 Scenario 1 that treats both IPO Shares and Pre-IPO Shares as part of the QSF. However, the

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26 ³ As stated above, the Receiver intends to engage a valuation expert to determine the tax basis once
27 the tax opinion is prepared and the Court approves the Plan, assuming that Scenario 1 is adopted.

1 Receiver seeks instructions from the Court as to whether to incur the costs and delays inherent in
2 Scenario 2 in an effort to try to lessen the tax liability. The Receiver has filed this Motion to
3 provide the investors, the creditors and the Court with an opportunity to review and consider the
4 issues before a final determination is made.

5 **VI. CONCLUSION**

6 For these reasons, the Receiver respectfully requests that the Court (1) approve the
7 employment of Miller Kaplan on the terms set forth herein; (2) approve the employment of
8 Schinner & Shain LLP on the terms set forth herein; and (3) instruct the Receiver whether to
9 pursue Scenario 1 or 2. The Receiver requests all other appropriate relief.

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11 DATED: August 15, 2019

By: /s/ Kathy Bazoian Phelps
Kathy Bazoian Phelps
Successor Receiver

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