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5 *Successor Receiver*

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8 **UNITED STATES DISTRICT COURT**
9 **NORTHERN DISTRICT OF CALIFORNIA**
10 **SAN FRANCISCO DIVISION**

11 SECURITIES AND EXCHANGE
12 COMMISSION,

13 Plaintiff,

14 v.

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

18 Defendants, and

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

22 Relief Defendants.
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Case No. 3:16-cv-01386-EMC

**MOTION BY RECEIVER KATHY
BAZOIAN PHELPS FOR ORDER
AUTHORIZING MODIFICATION OF
THE DISTRIBUTION PLAN**

Date: August 31, 2023

Time: 1:30 pm

Judge: Edward M. Chen

1 Kathy Bazoian Phelps, the successor receiver herein (the “Receiver”) of SRA Management
2 Associates, LLC, SRA I, LLC, SRA II, LLC, SRA III, LLC, Clear Sailing Group IV, LLC, Clear
3 Sailing Group V, LLC, Felix Multi-Opportunity Fund I, LLC, Felix Multi-Opportunity Fund II, LLC,
4 Felix Management Associates, LLC, NYPA Fund I, LLC, NYPA Fund II, LLC, NYPA Management
5 Associates, LLC and Solis Associates Fund LLC (collectively, the “Receivership Entities” and their
6 estates the “Receivership Estate”), hereby files this Motion for an Order Authorizing Modification
7 of the Distribution Plan (the “Motion”). The Receiver has conferred with the Securities and Exchange
8 Commission (“SEC”), the Investor Advisory Committee (“IAC”), Joshua Cilano, and counsel for
9 Progresso Ventures LLC and, except as noted herein, they do not have any response to the Motion.

10 I. INTRODUCTION

11 Since the Receiver’s Distribution Plan (the “Plan,” Dkt. No. 570-1) was approved by this
12 Court on May 25, 2020 (Dkt. No. 613),¹ the Receiver has largely completed implementation of the
13 Plan, distributing over \$83 million in stock and nearly \$8 million in cash to investors. The Receiver
14 has also filed her tax returns for 2020 and 2021, the years in which the bulk of the estate’s tax liability
15 with respect to the distribution was incurred. As part of her motions to distribute shares, sell for taxes,
16 and hold administrative reserves (Dkt. Nos. 617, 638, 657, 663), the Receiver has also requested
17 minor modifications to the Plan, most notably to hold the administrative reserves for each of the
18 following stocks in cash during the three-year audit period: Airbnb, Inc. (“Airbnb”), Bloom Energy
19 Corp. (“Bloom”); Cloudera, Inc. (“Cloudera”); Dropbox, Inc. (“Dropbox”); Lyft, Inc. (“Lyft”);
20 MongoDB, Inc. (“MongoDB”); Palantir, Inc. (“Palantir”); Pinterest, Inc. (“Pinterest”); Snap, Inc.
21 (“Snap”); and Uber, Inc. (“Uber”) (collectively, the “Publicly Traded Securities”).

22 The completion of the distribution of Publicly Traded Securities, made possible in part by
23 Palantir and Airbnb becoming Successful Investments after the Plan was approved, along with the
24 filing of the 2020 and 2021 tax returns, has removed much of the uncertainty that existed when the
25 Plan was approved at a time when the bulk of the estate’s value was locked into pre-Initial Public
26 Offering (“IPO”) securities. Now that the financial impact to investors of the distributions to Class 4

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28 ¹ Any capitalized term not defined herein shall have the meaning ascribed to it in the Plan.

1 investors is much more certain, the Receiver proposes the following clarifications and modifications
2 to the Plan:²

- 3 1. Complete the process begun with Palantir, Airbnb, and MongoDB, and create a
4 separate cash Class 4 Reserve subaccount³ for each of the other Publicly Traded
5 Securities, funded with the prior sales of those Publicly Traded Securities which are
6 currently being held in the Tax Holding Account, to be held during the pendency of
7 the three-year Internal Revenue Service (“IRS”) audit period and to be used in the
8 first instance for as-yet unassessed taxes and ultimately to pay cash distributions to
9 the Class 4 classes by investment class.
- 10 2. Adjust the Class 4 Reserve for each Publicly Traded Security to reflect the tax burden
11 or benefit for each Security based upon the actual tax burden or benefit to the estate
12 associated with each of the Publicly Traded Securities that is now known, as set forth
13 and explained herein.
- 14 3. Create a new distribution category for Evernote Corp. (“Evernote”) that accounts for
15 the particular circumstances of the disposition of the estate’s position in Evernote that
16 took place in December 2021. If the estate disposes of its positions in Addepar, Inc.
17 (“Addepar”), Lookout, Inc. (“Lookout”), or ZocDoc, Inc. (“ZocDoc”) before an IPO,
18 the Receiver will propose at that time a distribution methodology after consultation
19 with the SEC and the IAC, depending on the particular facts and circumstances of
20 such disposition. In the meantime, the Addepar, Lookout, and ZocDoc securities will
21 be held by the estate pending a liquidity event or other disposition as may be approved
22 by the Court.⁴

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24 _____
25 ² The Receiver notes that no distributions to investors will be made at this time, and a separate
26 motion will be filed following the closure of the three-year tax audit period to obtain authorization
27 of the exact amounts to be distributed at that time. The purpose of this Motion is to establish the
28 methodology and Plan provisions to prepare for such distribution.

³ The Receiver reserves the right to account separately for each subaccount without the need to
open new bank accounts for each such subaccount.

⁴ This Motion does not propose any disposition of these three securities at this time.

- 1 4. Determine the appropriate basis to calculate Class 5 Investor Deficiency Claims, *i.e.*,
- 2 on a per-investor basis or a per-security basis, as set forth and explained herein.
- 3 5. Create a Class 6A for Practice Fusion and a Class 6B for Candi Controls, to be funded
- 4 from the tax benefits Practice Fusion and Candi Controls provided to the estate, which
- 5 funds are presently being held in the Tax Holding Account. The tax benefits from the
- 6 Practice Fusion and Candi Controls Failed Investments have now been realized upon
- 7 the filing of the 2021 estate tax return and the losses from those two Failed
- 8 Investments can be quantified as offsets to the substantial gains in 2021. The Receiver
- 9 anticipates that any distribution of those proceeds shall be completed along with other
- 10 cash distributions to Class 3, 4 and 5 Claimants, following the closure of the three-
- 11 year IRS audit period and assuming no additional tax liability is assessed.

12 With resolution of those issues, the Receiver believes that the following two issues will
13 remain to be resolved prior to finalizing distribution and closing the case:

- 14 1. Determine how certain disgorgement funds obtained from relief defendant Anne
- 15 Bivona (the “Anne Bivona Funds”) should be allocated.⁵
- 16 2. Determine the proper treatment of the claim filed by Joshua Cilano (the “Cilano
- 17 Claim”), which was asserted based on the performance of his clients’ investments.⁶

18 The Receiver believes that, given the completion of the 2020 and 2021 tax returns and
19 distributions, it is in the best interest of the estate to resolve and implement the foregoing issues now,
20 with the understanding that the Receiver will return to the Court once the three-year audit period has
21 passed with additional recommendations based on the facts and circumstances at the time. The

22 _____
23 ⁵ The SEC has asked the Receiver to defer requesting relief on this issue at this time.

24 ⁶ The SEC previously objected to the Cilano Claim (Dkt. No. 572), but the objection was stayed
25 pending a determination as to whether there will be sufficient funds available to pay such claim if
26 allowed (Dkt. No. 613). The Receiver is advised that the SEC opposes any distribution on the
27 Cilano Claim and that Cilano continues to assert his claim against the estate. The Receiver
28 proposed a resolution to both parties, neither of which agreed to the proposed terms. Accordingly,
the Receiver is not moving at this time for a determination as to distribution on the Cilano Claim
but does request that the Court grant permission to the SEC to continue to prosecute its objection to
the Cilano Claim so that this matter can be resolved. A discovery schedule for the objection to
claim proceeding is suggested below.

1 Receiver further believes that holding these cash reserves, subject to any necessary equitable
 2 adjustment based on future developments, protects the cash position of the estate in case of an
 3 unexpected adverse tax action while still preserving value for claimants if no such action occurs.

4 **II. BACKGROUND**

5 **A. Distribution Plan**

6 The Plan creates five classes of claims: (1) Administrative Claims; (2) Priority Claims
 7 (consisting solely of tax claims); (3) Unsecured Creditor Claims, consisting of just under \$10 million
 8 in cash claims; (4) Investor Claims, consisting of fourteen subclasses 4A-4O of each of securities
 9 held by the estate at the time the Plan was approved; and (5) Subordinated Claims consisting of \$1.65
 10 million in known cash claims plus Investor Deficiency Claims. (Plan at 10-13.)⁷

11 As the primary intent of investments in the Receivership Entities was generally to receive
 12 securities in the various underlying companies once they went public or had a similar liquidity event,
 13 the Plan was structured to distribute the securities held by the estate once they became a Successful
 14 Investment. (Plan at 18-19.) A Successful Investment was one for which a liquidity event had
 15 occurred, such as an initial public offering or a direct listing. (Plan at 7.) Such a liquidity event would
 16 allow the shares in the company to become freely tradeable, which would allow them to be distributed
 17 to investors, unlike pre-IPO shares which are generally not freely tradeable.

18 The Plan also recognized that under the applicable tax laws that govern the Receivership
 19 Estate, which is a Qualified Settlement Plan (“QSF”) under IRS regulations, the estate would be
 20 responsible for significant taxes with respect to the sale or distribution of the shares, and that the sale
 21 of shares would be required to satisfy those significant tax obligations. (Plan at 19.) The Plan also
 22 recognized that the estate needed cash to satisfy Class 1, 2, 3, and 5 Claims, and that the assets of the
 23 estate were the shares in the underlying securities. The Plan therefore required, after significant
 24 negotiation with the SEC and IAC to come to a generally acceptable solution, that once a liquidity
 25

26 ⁷ There is presently no accommodation in the Plan for the Cilano Claim or for the claims arising
 27 from the Failed Investments. This Motion addresses a subcategory of Failed Investments (Candi
 28 Controls and Practice Fusion) that generated tax benefits for the estate, but the handling of the
 other Failed Investments and the Cilano Claim may be addressed in the future, depending on the
 outcome of this Motion and the outcome of the SEC’s objection to the Cilano Claim.

1 event occurred, each subclass was required to contribute 30% of the total gross investment in that
2 security to the Plan Fund, by sale of the underlying stock. (Plan at 15-16.)

3 The Plan recognized that, due to inherent challenges in valuing pre-IPO stock, it would be
4 necessary to engage a valuation expert to determine the tax bases for the various shares in the estate,
5 which in turn determined the estate's tax liability. (Plan at 19.) In order to protect the estate and the
6 Receiver from the chance of a later challenge to that tax basis by a taxing authority, the Plan also
7 allowed the Receiver to retain an administrative stock reserve in the Publicly Traded Securities to
8 ensure that the estate had sufficient funds to satisfy all tax obligations, known and unknown. (Plan
9 at 18-19.)

10 Once the Receiver began to implement the Plan, it became clear that the Receiver would be
11 able to minimize the amount of administrative reserves held if she could hold those reserves as cash
12 rather than stock, as the estate would not be exposed to future fluctuations in the stock price. Upon
13 the sole distribution of Palantir, Airbnb, and upon the second distribution of the remaining Publicly
14 Traded Securities, the Receiver moved this Court to modify the Plan to convert those administrative
15 reserves to cash, which this Court granted in each instance. (Dkt. Nos. 638, 657, 663.) The further
16 modifications set forth herein finalize that process, taking into account the actual 2020 and 2021 tax
17 returns, so that the Class 4 Reserves can be segregated as indicated in those prior motions for each
18 subclass until they are needed or the IRS audit period passes.

19 The Plan contemplated that investments would either be a Successful Investment that
20 underwent an IPO or similar transaction, or a Failed Investment. As explained to the Court in the
21 Receiver's motion to sell Evernote (Dkt. No. 670), it was in the best interest of the estate to liquidate
22 Evernote such that it is neither a Successful Investment nor a Failed Investment. The Receiver will
23 therefore propose a new distribution methodology for Class 4F (Evernote) Claimants that accounts
24 for the specific circumstances of the Evernote sale.

25 The Plan recognized that a number of companies in which investors had invested through
26 SRA had failed and categorized those as Failed Investments. Because those companies would have
27 failed regardless of any alleged malfeasance by the former managers of the Receivership Entities,
28 the Plan does not allow for a distribution on claims for Failed Investments. Two of those investments,

1 Practice Fusion and Candi Controls, failed after the receivership was created, which resulted in a
2 substantial loss to the estate. At the time the Court approved the Plan, those losses had been carried
3 forward, but the estate had not yet realized any benefit from those losses, and so the Court reserved
4 judgment on how to treat claimants in Practice Fusion and Candi Controls. As a result of the gains
5 in 2021, reflected in the 2021 tax return, the estate has realized a tax benefit of over \$1 million for
6 Practice Fusion and over \$1.8 million for Candi Controls. The Receiver therefore believes that those
7 funds, currently held in the Tax Holding Account, should be allocated to a new class of claimant –
8 Class 6A for Practice Fusion and Class 6B for Candi Controls – to be distributed at a later date.

9 In Class 5, the Receiver also contemplated that a shortfall of shares to each investor would
10 be treated as an Investor Deficiency Claim, but at the time there was insufficient information to
11 determine the balance of the equities as to how those deficiencies would be calculated and
12 apportioned. (Plan at 18.) Now that the financial picture of the estate is clearer, the Receiver believes
13 there is sufficient information to further specify how such Investor Deficiency Claims should be
14 calculated and proposes a solution in Part III.D, *infra*.

15 The entire Plan was subject to further equitable adjustments (Plan at 20), as it was not clear
16 at the time which investments would be successful – with significant uncertainty around Palantir, by
17 far the estate’s largest holding – and whether the Plan would result in some claimants receiving a full
18 distribution of the value of their claims while others would not. The Receiver does not propose that
19 *any* distribution of cash be made until at least the IRS audit period for the 2021 tax year has passed
20 (anticipated in April 2025), and any distribution at that point will be subject to any necessary
21 equitable adjustment proposed by the Receiver after consultation with the SEC and the IAC, and
22 approved by the Court.

23 If the Receiver’s recommendations set forth in this Motion are adopted, there will be
24 sufficient funds to pay Class 1, 2, 3, 4 and 5 Claims in full, leaving a surplus⁸ of likely over \$95,000.
25 If, however, the Receiver’s recommendation regarding calculation of the Class 5 Deficiency Claims
26 _____

27 ⁸ This number may increase upon disposition of Lookout, ZocDoc, and Addepar, and with the
28 inclusion of interest income; or could decrease depending on actual versus estimated Class 1 or 2
claims.

1 of Class 4 investors is not adopted, there will not be sufficient funds to distribute to Class 5 Claimants
2 in full. *See* Exhibit “6” attached to the Receiver’s Declaration.

3 **B. Status of Plan Implementation**

4 In December 2020, after Palantir went public and the Receiver was able to increase the Plan
5 Fund by nearly \$10 million, this Court approved a distribution to Class 3 Unsecured Creditor Claims
6 of 80% of their total allowed Class 3 Claims. By January 2021, the Receiver completed that
7 distribution, distributing \$7,721,752.95 to Class 3 Claimants, with an additional \$1,930,438.28
8 remaining on those claims.

9 Beginning in July 2020, and continuing in four separate distributions until August 2021, the
10 Receiver sold the necessary shares for the ten Publicly Traded Securities to fund the Plan Fund, pay
11 necessary taxes and commissions, and to hold appropriate administrative reserves. The Receiver also
12 completed the distributions of the shares in the Publicly Traded Securities to the claimants, and the
13 estate is no longer in possession of shares in those securities. A summary of the sale, distribution,
14 and tax impact to the estate for each of the Publicly Traded Securities is attached to the Receiver’s
15 Declaration as Exhibit “1.”

16 The Receiver, on motion to this Court in December 2021, also sold the estate’s position in
17 Evernote in order to obtain the significant tax benefit available from doing so in the 2021 calendar
18 year. The Receiver is holding the proceeds of that sale in a segregated account and proposes herein
19 a new type of Class 4 distribution method for Evernote.

20 **C. Current Status of Taxes and Reserves**

21 As of May 31, 2023, the cash reserves in the estate totaled more than \$24 million
22 as follows:

23	Wells Fargo Checking	\$0.00
24	Anne Bivona Funds	\$539,797.80
25	Plan Fund Account	\$4,481,437.68
26	Tax Holding Account	\$5,152,224.64
27	Palantir Administrative Reserve	\$13,432,846.78
28	MongoDB Administrative Reserve	\$410,797.82
	Airbnb Administrative Reserve	\$120,687.70
	Evernote Reserve	\$98,144.70
	Total Cash on Hand	\$24,235,937.12

1 For the 2020 return, there was no cash outlay as the loss carryforwards were applied. The
 2 2021 return resulted in a total refund of \$306,200, of which \$234,893 came from the IRS and \$71,307
 3 from the California Franchise Tax Board (“FTB”).⁹ *Id.* Those funds were deposited in the Tax
 4 Holding Account, and the total cash reserves after that refund are \$24,235,937.12, with interest
 5 continuing to accrue.

6 In addition, now that the tax returns for 2020 and 2021 have been filed, the tax liability or
 7 benefit with respect to each security can be calculated and is set forth for each security in the
 8 Damasco Declaration, attached hereto, and are summarized as follows:

TAX LIABILITIES AND BENEFITS OF EACH CLASS 4 SECURITY			
Class 4 Reserve	Total Tax Liability or Benefit from 2020	Total Tax Liability or Benefit from 2021	Total Tax Liability or Benefit from 2020-2021
Airbnb Class 4B	\$0.00	(\$904,835.59)	(\$904,835.59)
Bloom Class 4C	\$464,642.82	(\$54,775.92)	\$409,866.90
Cloudera Class 4D	\$121,286.04	\$1,846.23	\$123,132.27
Dropbox Class 4E	\$18,997.78	(\$35,196.64)	(\$16,198.86)
Evernote Class 4F	\$0.00	\$297,984.40	\$297,984.40
Lyft Class 4H	\$63,325.52	(\$269.89)	\$63,055.63
MongoDB Class 4I	(\$1,279,134.65)	(\$536,760.15)	(\$1,815,894.80)
Palantir Class 4J	(\$78,396.72)	(\$30,750,610.41)	(\$30,829,007.13)
Pinterest Class 4K	(\$28,446.87)	(\$36,548.64)	(\$64,995.51)
Snap Class 4M	\$78,979.91	(\$178,267.46)	(\$99,287.55)
Uber Class 4O	\$530.84	(\$42.14)	\$488.70
Total	(\$638,215.33)	(\$32,197,476.21)	(\$32,835,691.54)

17
 18 As these results show, largely due to the success of Palantir, the estate incurred enormous
 19 amounts of tax liabilities with respect to the Class 4 distributions, over \$32 million, somewhat offset
 20 by the tax benefits from two of the Failed Investments and other operating losses.

21 **III. PROPOSED CHANGES TO THE DISTRIBUTION PLAN**

22 **A. Finalize and Hold Class 4 Reserves for the Publicly Traded Securities**

23 As stated above, the Court has already approved the liquidation of the administrative stock
 24 reserves into cash. Palantir, Airbnb, and MongoDB each have their own reserves already segregated
 25 into separate accounts while the reserves for the other Publicly Traded Securities are currently being
 26 held in the Tax Holding Account. The Plan also called for the liquidation of some of the Publicly
 27

28 ⁹ An additional \$6,500 in refunds were rolled over for 2022 taxes.

1 Traded Securities to pay estimated taxes and reserves, which was done. The Receiver has also filed
 2 tax returns for 2020 and 2021, meaning that the precise tax liability from each Publicly Traded
 3 Security is now known and can be calculated.

4 Moreover, under the structure of the Plan, Class 4 is divided into subclasses by security, and
 5 each subclass is responsible for the taxes arising from the disposition of the associated security. As
 6 such, shares of each security were sold to pay for the tax burden associated with the disposition of
 7 that security, leaving fewer shares to distribute to that subclass. The Receiver believes that, under the
 8 same logic, to the extent that the disposition of a security provided a quantifiable tax benefit to the
 9 estate, the associated subclass should receive that benefit from the Tax Holding Account into its
 10 Class 4 Reserve. Now that the 2021 tax return has been filed, the Receiver proposes to use the
 11 numbers from the actual returns, combined with the actual results of the stock sales, to fix the Class
 12 4 Reserve, the funds of which will be available in the first instance to the IRS or the FTB if required
 13 by any future but unanticipated tax assessment, which would be a Class 2 Claim.

14 Therefore, the total Class 4 Reserve for each Publicly Traded Security will begin with the
 15 cash the estate received from the sales of that security's stock (and in the case of MongoDB, the
 16 Sabrin Settlement as well (*see* Status Report for First Quarter 2023, Dkt. No. 700, at 4-5)), less the
 17 contribution to the Plan Fund. If the total tax impact from the disposition of that security was a cost
 18 to the estate, that cost will be deducted from the reserve. If the total tax impact from the disposition
 19 of that security was a benefit to the estate, that benefit will be added to the reserve (from the Tax
 20 Holding Account). For each security, that results in the following reserves:

CLASS 4 RESERVES					
Class 4 Reserve	A. Cash from Stock Sales and Settlements (after Plan Fund contribution)	B. Tax Liability or Benefit from 2020-2021	C. Total Reserve (C = A + B)	D. Amount Already Contributed	E. Remaining Contribution (E = C - D)
Airbnb Class 4B	\$1,023,009.09	(\$904,835.59)	\$118,173.50	\$118,172.34	\$1.16
Bloom Class 4C	\$274,667.38	\$409,866.90	\$684,534.28		\$684,534.28
Cloudera Class 4D	\$5,038.91	\$123,132.27	\$128,171.18		\$128,171.18
Dropbox Class 4E	\$129,166.53	(\$16,198.86)	\$112,967.67		\$112,967.67
Lyft Class 4H	\$5,901.28	\$63,055.63	\$68,956.91		\$68,956.91

CLASS 4 RESERVES					
Class 4 Reserve	A. Cash from Stock Sales and Settlements (after Plan Fund contribution)	B. Tax Liability or Benefit from 2020-2021	C. Total Reserve (C = A + B)	D. Amount Already Contributed	E. Remaining Contribution (E = C - D)
MongoDB Class 4I	\$1,964,957.12 ¹⁰	(\$1,815,894.80)	\$149,062.32	\$402,000.00	(\$252,937.68)
Palantir Class 4J	\$44,131,541.89	(\$30,829,007.13)	\$13,302,534.76	\$13,126,730.95	\$175,803.81
Pinterest Class 4K	\$68,469.82	(\$64,995.51)	\$3,474.31		\$3,474.31
Snap Class 4M	\$372,456.31	(\$99,287.55)	\$273,168.76		\$273,168.76
Uber Class 4O	(\$138.70)	\$488.70	\$350.00		\$350.00
Total	\$47,975,069.63	(\$33,133,675.94)	\$14,841,393.69	\$13,646,903.29	\$1,194,490.40

As set forth in the prior motions for distributions of the Publicly Traded Securities, the Receiver has already created reserves for Palantir, Airbnb, and MongoDB. For the other seven securities, the Receiver proposes to create a Class 4 Reserve for each with the foregoing amounts transferred from the Tax Holding Account. For Palantir, the contribution was \$13,126,730.95, which means an additional contribution of \$175,803.81 is necessary. For MongoDB, a total of \$402,000.00 has been contributed from the Sabrin Settlement, some of which the Receiver expected to use to satisfy the tax obligations (Dkt. No. 663-1, Phelps Decl. ¶ 7), requiring a transfer of \$252,937.68 from the MongoDB Class 4I Reserve to the Tax Holding Account. That will still leave \$149,062.32 in the MongoDB Class 4I Reserve. A comparison of the estate's cash position before and after the proposed transfers is attached to the Receiver's Declaration as Exhibit "2." The balance that will remain in the Tax Holding Account following the movement of funds into the segregated Class 4 Reserve accounts will be \$749,055.25.¹¹

The Receiver proposes that each Class 4 Reserve be held until the IRS audit period has passed and the final tax liabilities of the estate are fixed. If those Class 4 Reserves are not needed to satisfy

¹⁰ The MongoDB cash received includes \$402,000.00 in installment payments from the Sabrin Settlement already received by the estate.

¹¹ Exhibit 2 also contains the proposed adjustments for Evernote and Failed Investments, discussed *infra*. Even after all the proposed adjustments are made, after the \$306,200 refund was received by the estate, the Tax Holding Account will still have over \$749,000, largely reflecting tax benefits from the operating losses over the life of the receivership. Once the final tax liabilities of the estate are determined, the Receiver expects to propose to collapse the remainder of the Tax Holding Account into the Plan Fund.

1 any additional as-yet unassessed taxes (which would be Class 2 Claims), then the Receiver expects
2 that the Class 4 Reserves will be paid as cash to Class 4 Claimants, subject to any equitable
3 modification the Receiver may propose based on the facts and circumstances at that time.

4 **B. Create Separate Distribution Category for Evernote Class 4F Claims**

5 The Plan currently contemplates two types of investments: Successful Investments for which
6 there is a liquidity event such as an IPO (Plan at 18-19), and Failed Investments for which claims
7 have been disallowed (Plan at 9). If an investment becomes a Successful Investment, the Plan
8 contemplates that a portion of that investment (30% of the gross investment by dollar) shall fund the
9 Plan Fund, which has been done for the ten Publicly Traded Securities, and the remainder after taxes
10 and reserves will be distributed to claimants as freely tradeable shares, rather than cash, to best give
11 the claimants the original benefit of their bargain. For investments that became Failed Investments,
12 on the other hand, the claimants who had intended to purchase those investments had taken the risk
13 that they would fail, and they did, and therefore the claims were disallowed, subject to any tax
14 adjustment as set forth in Part III.C below.

15 With Evernote, the Receiver was faced with a third scenario. Evernote was a pre-IPO
16 investment that had not yet become a Failed Investment and therefore still had value to the estate
17 both in the liquidation value of the security and in the tax benefit to the estate that could be achieved
18 by offsetting other gains. But even though Evernote was not a Failed Investment, it also was not a
19 Successful Investment, which meant that it did not have the liquidity event (*i.e.*, an IPO) that would
20 have made the shares freely tradeable, with an increase in value such that a contribution could be
21 made to the Plan Fund with substantial value remaining for Class 4F Claimants.

22 For Evernote, the proceeds from the sale were \$96,108, which has been placed in a separate
23 Evernote Class 4F Reserve. The transfer and legal fees associated with that sale were \$2,838.35 were
24 initially paid by the Plan Fund, and therefore that amount should be transferred from the Evernote
25 Class 4F Reserve to the Plan Fund. The loss associated with the Evernote sale was \$700,000,
26 resulting in a tax benefit of \$297,984.40 to the estate, which the Receiver proposes to transfer from
27 the Tax Holding Account to the Evernote Class 4F Reserve. The entirety of the funds in the Evernote
28 Class 4F Reserve will therefore be \$393,290.75, as reflected in Exhibit 2.

1 If Evernote were characterized as a Successful Investment under the Plan, then nearly the
2 entire sale proceeds and tax benefit would be allocated to the Plan Fund as its 30% contribution. The
3 total gross investment in Evernote was \$1,179,964, so the Plan Fund contribution if Evernote were a
4 Successful Investment would be \$353,989.20, leaving less than \$40,000 to be distributed to Evernote
5 Claimants, even if none of the reserve is needed for additional taxes. See Exhibit “7” attached to the
6 Receiver’s Declaration. However, under that methodology, each Evernote Claimant would then have
7 a near-total loss that would be included in that claimant’s Deficiency Claim, funded by the excess
8 funds in the Plan Fund, with the amount to each claimant depending on how the Court resolves the
9 deficiency question set forth in Part III.D, *infra*. The Receiver does not believe that adherence to the
10 30% contribution methodology is workable with respect to Evernote as that would result in a near
11 total loss for those investors.

12 The average investment price for Evernote was over \$13 per share, the estate’s basis was \$8
13 per share, and the sale price was only \$1 per share,¹² resulting in a tax loss of \$7 per share, and an
14 actual loss for investors of \$12 per share. Evernote is much more akin to a Failed Investment for
15 which the Receiver was able to recover some amount of value. In consultation with the SEC, the
16 Receiver believes that it would be equitable to allow Class 4F Claimants to receive the value of the
17 sale proceeds plus the tax benefit from the loss (proposed to be held in the Evernote Class 4F Reserve)
18 *pro rata* based on each claimant’s percentage of allowed Evernote shares, provided that any such
19 reserves are not needed for additional as yet unassessed taxes.

20 Further, because Evernote is akin to a Failed Investment, the Receiver proposes (i) that no
21 contribution need be made to the Plan Fund, and (ii) that the remaining Evernote losses are not
22 characterized as Class 5 Deficiency Claims that would be paid from the excess in the Plan Fund.¹³

23 _____
24 ¹² As Evernote is still a private company, Evernote retained its right of first refusal to preempt the
25 buyer and purchase the shares the estate sold at \$1 per share. Evernote declined to do so.

26 ¹³ If and when the Receiver is able to liquidate the interests in the remaining pre-IPO investments
27 (Addepar, Lookout, and ZocDoc), the Receiver will propose to create a third category, Pending
28 Investment, for any of Addepar, Lookout, and ZocDoc that would become similar in characteristic
to Evernote after disposition, where it is more like a Failed Investment, but not a Successful
Investment. Such Pending Investment would then be treated in the same manner as Evernote under
the Plan.

1 The Receiver therefore proposes that the Evernote Class 4F Reserve be held until the audit period
 2 passes, and after that date the Receiver will make a specific distribution motion that will include
 3 distributing any remainder of the Evernote Class 4F Reserve to Class 4F Claimants.

4 **C. Tax Benefits from Failed Investments (Candi Controls and Practice Fusion)**

5 In the Court's order approving the Plan, the Court suggested that the tax benefit to the estate
 6 associated with the Failed Investments might be fairly distributed to the investors in those
 7 investments. (Dkt. No. 613, ¶ 5.) The estate realized nearly \$7 million in losses with respect to Candi
 8 Controls in 2018 and Practice Fusion in 2019. Both of those losses were carried forward to 2020,
 9 where they were applied (along with operating losses) to reduce the estate's 2020 tax burden to zero,
 10 and they were further carried forward to 2021 to further reduce the estate's tax burden by being netted
 11 against the substantial gains the estate realized in its disposition of the Publicly Traded Securities.

FAILED INVESTMENTS TAX BENEFITS			
Security	Loss	Date of Loss	Benefit to Estate
Candi Controls	(\$4,285,560.00)	5/3/2018	\$1,824,328.61
Practice Fusion	(\$2,552,000.00)	4/17/2019	\$1,086,365.98
Total	(\$6,837,560.00)		\$2,910,694.59

12
 13
 14
 15 These specific tax benefits were realized by lowering the tax burden of the estate, which is
 16 reflected by the fact that the Tax Holding Account currently has a balance of over \$5.1 million.
 17 Because these tax benefits relate to specific investments, the Receiver proposes the creation of two
 18 separate Class 6 subclasses for each investment: Class 6A for Practice Fusion and Class 6B for Candi
 19 Controls. The Receiver further proposes that the realized benefit from the estate for each of those
 20 two investments, up to the total Allowed Shares as discussed below, be transferred to a newly created
 21 Class 6A Practice Fusion Reserve, and a Class 6B Candi Controls Reserve.

22 The Receiver has prepared schedules of the impacted investors and the estimated *pro rata*
 23 distribution of these tax benefits to those investors. Those schedules are attached to the Receiver's
 24 Declaration as Exhibits "4" and "5."

25 For Practice Fusion, there are more Allowed Shares than shares that were owned by the estate,
 26 and the Receiver therefore proposes that the entire tax benefit be transferred to the Class 6A Practice
 27 Fusion Reserve as reflected in Exhibit 2. For Candi Controls, there were 1,999,685 Allowed Shares
 28

1 and 2,267,492 shares owned by the estate, for a surplus of 267,807 shares. Pursuant to the Plan,
2 surplus shares are contributed to the Plan Fund, so the Receiver accordingly proposes that the tax
3 benefits associated with those excess shares (\$215,466.23) be contributed to the Plan Fund, with the
4 remaining amount contributed to the Class 6B Candi Controls Reserve as reflected on Exhibit 2. For
5 the amounts held in the Practice Fusion and Candi Control Reserves, the Receiver believes that—as
6 with the Class 3 and 4 Reserves—any distribution should not occur until the closure of the IRS audit
7 period.

8 **D. Treatment of Class 5 Deficiency Claims**

9 Under the Plan, Investor Deficiency Claims are any remaining unpaid Investor Claims
10 following distribution of shares pursuant to the terms of the Plan “that should be calculated as
11 follows: the gross dollar amount invested by an Investor, less 30% of the gross investment amount,
12 less the Investor’s *pro rata* share of the total dollar value generated to fund the Tax Holding Account,
13 less the value of any shares actually distributed to the Investor under the terms of this Plan (calculated
14 as the posted value of those shares as of the close of business on the dates that the shares are actually
15 distributed to the Investor).” (Plan at 5.)

16 The Receiver requests instructions from the Court on how Class 5 Investor Deficiency Claims
17 should be treated. Given the substantial gains that many investors have received from the stock
18 distributions, the question arises as to whether (1) an investor’s Class 5 Deficiency Claim in
19 Successful Investments where a loss was suffered in one security should be offset by the gains
20 received by that investor in another security; or alternatively, (2) the investments should be kept
21 separate, leading to retention of the gain in one security and the allowance of a Deficiency Claim in
22 another security.

23 As a threshold matter, this analysis does not in any way impact the amount of distribution
24 already made or to be made to Class 4 investors on account of the stock and cash distributions and
25 reserves are previously accounted for and as accounted for herein. This question relates solely to the
26 amount of Deficiency Claims, if any, of Class 4 creditors since Deficiency Claims are a part of the
27 allowed claims of Class 5. The amount at issue for distribution to Class 5 Claimants will be any
28 amount in excess in the Plan Fund following payment in full to Class 1, 2, 3 and 4 Claimants under

1 the terms of the Plan. That surplus amount, as presently estimated to flow to Class 5 Claims, is
2 approximately \$3,060,000. The Class 5 Claims total either \$2,673,227.43 if Option 1 is used (leaving
3 a surplus of at least \$95,131.80 beyond Class 5,) or total Class 5 Claims of \$5,308,488.43 if Option
4 2 is used (leaving no surplus and providing for a 52% distribution to Class 5 Claimants). *See* Exhibit
5 6.

6 As explained in more detail, the difference in method of calculation leads to different
7 outcomes:

8 (1) If an investor's total gains are used to offset total losses before any deficiency is
9 calculated, the total deficiency will be approximately \$1 million, and (barring any
10 significant adverse tax decision) there will likely be sufficient reserves in the Plan Fund
11 to satisfy 100% of all currently approved Class 3 Cash Claims and Class 5 Subordinated
12 Claims.

13 (2) If the investor's gains are not used to offset losses, the total deficiency will be
14 approximately \$3.6 million, and (again, barring any significant adverse tax decision),
15 there will likely *not* be sufficient reserves in the Plan Fund to satisfy all currently
16 approved Class 3 Cash Claims and Class 5 Subordinated Claims, and distribution on the
17 Deficiency Claims will be likely be in the 25%-65% range, although even that is not
18 certain.

19 To explain this further, the Receiver will first explain the two methods for how to calculate
20 Deficiency Claims, and then highlight how the equities might differ in distributing under either
21 method.

22 1. *Calculating Deficiency Claims*

23 The Receiver sees two possible options for how to calculate Deficiency Claims, with
24 substantially different impacts on a future Class 5 distribution:

25 **Option 1 (net total losses against total gains).** For each Successful Investment, calculate
26 the total deficiency or gain based on the total value distributed to the investor with respect to such
27 investment, less the total gross investment by that investor. Aggregate the total gains and losses, with
28 the net losses (if any) being the investor's Deficiency Claim.

1 **Option 2 (aggregate losses only).** For each Successful Investment, calculate only the
 2 respective losses and aggregate those for the investor's Deficiency Claim, while disregarding the
 3 gains the investor received in other distributions for purposes of calculating the Deficiency Claim.

4 The differences between these methods can most easily be seen in three illustrative examples,
 5 which will also help to demonstrate the difference in equities. The Receiver is using these examples
 6 in order to avoid discussing the equities surrounding specific claimants in the Motion.

7 Example 1 (Investor A, net loss): Investor A had the following two investments:

- 8 • Cloudera with \$75,000 gross investment; and a total distribution value of \$25,000.¹⁴ Investor
 9 A's loss from Cloudera is \$50,000 (\$25,000 less \$75,000).
- 10 • MongoDB with \$30,000 gross investment; and a total distribution value of \$70,000. Investor
 11 A's gain from MongoDB is \$40,000 (\$70,000 less \$30,000).

12 Under Option 1, the gain from MongoDB (\$40,000) is used to offset the loss from Cloudera
 13 (\$50,000), and Investor A has a total deficiency of \$10,000. Under Option 2, the gain from MongoDB
 14 is disregarded, the losses are aggregated, and Investor A has a total deficiency of \$50,000.

15 Example 2 (Investor B, net gain): Investor B had the following two investments:

- 16 • Cloudera with \$175,000 gross investment; and a total distribution value of \$25,000. Investor
 17 B's loss from Cloudera is \$150,000 (\$25,000 less \$175,000).
- 18 • Palantir with \$100,000 gross investment; and a total distribution value of \$450,000. Investor
 19 B's gain from Palantir is \$350,000 (\$450,000 less \$100,000).

20 Under Option 1, the gain from Palantir (\$350,000) is used to offset the loss from Cloudera
 21 (\$150,000), and Investor B has a total gain of \$200,000 and a total deficiency of \$0. Under Option
 22 2, the gain from Palantir is disregarded, and Investor B has a total deficiency of \$150,000.

23 Example 3 (Investor C, net loss): Investor C had the following two investments:

- 24 • Cloudera with \$75,000 gross investment; and a total distribution value of \$25,000. Investor
 25 C's loss from Cloudera is \$50,000 (\$25,000 less \$75,000).
- 26 • Dropbox with \$100,000 gross investment; and a total distribution value of \$25,000. Investor
 27 C's loss from Dropbox is \$75,000 (\$25,000 less \$100,000).

28 ¹⁴ The total distribution value is the sum of the value of the shares in the first distribution, the value
 of the shares in the second distribution, and the Class 4 cash distribution after final tax liabilities
 are resolved.

Under either option, the losses are aggregated, and Investor C has a total loss of \$125,000 and a total deficiency of \$125,000.

The above three examples are presented in the following tables:

Investor A			Investor B		
	Cloudera	MongoDB		Cloudera	Palantir
Investment	\$ 75,000	\$ 30,000	Investment	\$ 175,000	\$ 100,000
Distribution	\$ 25,000	\$ 70,000	Distribution	\$ 25,000	\$ 450,000
Gain / Loss	\$(50,000)	\$ 40,000	Gain / Loss	\$(150,000)	\$ 350,000
Option 1			Option 1		
Gain	\$ 40,000		Gain	\$ 350,000	
Loss	\$(50,000)		Loss	\$(150,000)	
Net Loss	\$(10,000)		Net Gain	\$ 200,000	
Total Deficiency	\$(10,000)		Total Deficiency	\$ -	
Option 2			Option 2		
Aggregate Losses	\$(50,000)		Aggregate Losses	\$(150,000)	
Total Deficiency	\$(50,000)		Total Deficiency	\$(150,000)	
Investor C					
	Cloudera	Dropbox			
Investment	\$ 75,000	\$ 100,000			
Distribution	\$ 25,000	\$ 25,000			
Gain / Loss	\$ (50,000)	\$ (75,000)			
Option 1					
Gain	\$ -				
Loss	\$(125,000)				
Net Loss	\$(125,000)				
Total Deficiency	\$(125,000)				
Option 2					
Aggregate Losses	\$(125,000)				
Total Deficiency	\$(125,000)				

2. *Impact on All Class 5 Claimants Under Each Method*

Because there is a wide discrepancy in the total value of the Deficiency Claims depending on

1 which calculation method is used, the Receiver projects that the percentage *pro rata* payout for Class
 2 5 will be much higher if Option 1 is used. Based solely on the Successful Investments to date, and
 3 assuming that the Reserves will be fully distributed to investors, the total Deficiency Claims under
 4 Option 1 will be approximately \$1 million, and under Option 2 will be approximately \$3.6 million.
 5 There are additional Class 5 approved Subordinated Claims for \$1.7 million as well. The difference
 6 between the two methods can be seen in the following chart:

CLASS 5 PROJECTED WATERFALLS		
	Option 1 Gains Included	Option 2 Gains Disregarded
Plan Fund Value¹⁵	\$5.4 million	\$5.4 million
Class 1 Claims	\$0.8 million	\$0.8 million
Class 2 Claims ¹⁶	-	-
Class 3 Claims	\$1.9 million	\$1.9 million
Class 4 and 6 Claims	<i>Not Paid from Plan Fund</i>	
Amount Available for Class 5 Claims	\$2.7 million	\$2.7 million
Class 5 Non-Investor Claims	\$1.7 million	\$1.7 million
Class 5 Investor Deficiency Claims	\$1.0 million	\$3.6 million
Total Class 5 Claims	\$2.7 million	\$5.3 million
Projected Pro Rata %	100%	50%

15 If the Court selects Option 1, there is a likelihood that all Class 5 Claimants will be paid close to
 16 100%, but if the Court selects Option 2, there is virtually no chance that the payout will be near
 17 100%, with 50% being a reasonable projection. These numbers are projections, and the actual
 18 numbers could vary substantially.

19 3. *Distributions to Class 5 Investor Deficiency Claimants Under Each Method*

21 _____
 22 ¹⁵ The estimated Plan Fund value is the value of the Plan Fund and the Tax Holding Account as of
 23 May 31, 2023, after the adjustments in Exhibit 2, including the 2021 tax refund. Contributions from
 Addepar, Lookout and ZocDoc are assumed to be zero solely for purposes of analysis. The Anne
 Bivona Funds have been excluded from the calculations.

24 All of the figures in this table are based on the good faith estimates of the Receiver at the time of
 the filing of this Motion. Actual figures may differ.

25 ¹⁶ The Receiver does not anticipate any future Class 2 Claims other than taxes generated from the
 26 future sale and distribution of securities, which will be paid from the sales proceeds of such
 27 securities. In the unlikely event there are unanticipated future Class 2 Claims, those would not
 28 necessarily be paid from the Plan Fund, and as-yet unassessed taxes may instead be paid from
 Class 4 Reserves, as set forth above. In the event of a future assessment the Receiver will seek
 authority to pay from the appropriate source depending on the facts and circumstances of any such
 assessment.

1 Solely for purpose of analysis, the projections above assume that Deficiency Claims are paid
 2 100% if calculated under Option 1, and 50% if calculated under Option 2. As a result, some Class 5
 3 Deficiency Claimants will fare better under Option 1, and others will fare better under Option 2. By
 4 way of example, here is how Investors A, B, and C from the examples above would fare under each
 5 method (again, using hypotheticals to avoid singling out specific claimants in this Motion):

HYPOTHETICAL DEFICIENCY CLAIM ANALYSIS (ILLUSTRATIVE EXAMPLES)					
Claimant	Total Gain/Loss	Deficiency Claim		Distribution Amount	
		Option 1 Gains Included	Option 2 Gains Disregarded	Option 1 (100%) Gains Included	Option 2 (50%) Gains Disregarded
Investor A	(\$10,000)	(\$10,000)	(\$50,000)	\$10,000	\$25,000
Investor B	\$200,000	\$0	(\$150,000)	\$0	\$75,000
Investor C	(\$125,000)	(\$125,000)	(\$125,000)	\$125,000	\$62,500
Total	\$65,000	(\$135,000)	(\$325,000)	\$135,000	\$162,500

11 The differences in the equities can be seen in this hypothetical example. Under Option 2, Investor B
 12 receives the largest distribution—essentially a windfall—despite having already received a net gain
 13 of \$200,000 from the Receivership, whereas Investor C receives less despite having a net loss of
 14 \$125,000 from the Receivership and is not made whole. Under Option 1, however, Investors A and
 15 C are still given a full distribution on their total aggregate losses, and all investors are made whole.
 16

17 The Receiver has attached as Exhibit “3” to her declaration a summary of each claimant’s
 18 deficiency calculation based upon the current list of Successful Investments and assuming the Class
 19 4 reserves are all distributed, as well as the distribution amount if 100% is assumed for Option 1 and
 20 50% is assumed for Option 2. The Receiver cautions claimants that these are not the final numbers
 21 that would be used, but endeavors to give claimants the best projection currently possible so that any
 22 affected claimant will have the opportunity to address the Court if he or she so chooses.

23 4. *Recommendation*

24 The Receiver believes that Option 1 is the most equitable and appropriate under the
 25 circumstances and recommends that gains and losses for Successful Investments be aggregated to
 26 determine the amount of a Class 5 Deficiency Claim, if any. Based on the current Successful
 27 Investments, there are only 27 investors that would have deficiencies under Option 1, and 82 that
 28 would have deficiencies under Option 2. In other words, there are 27 investors who have a total loss

1 across all Successful Investments, and 55 additional investors who had losses in some Successful
2 Investments but had gains in other Successful Investments that outweighed those losses.

HYPOTHETICAL DEFICIENCY CLAIM ANALYSIS (ACTUAL CLAIMANTS – AGGREGATE DATA)					
Claimants	Total Gain/Loss	Deficiency Claim		Distribution Amount	
		Option 1 Gains Included	Option 2 Gains Disregarded	Option 1 (100%) Gains Included	Option 2 (50%) Gains Disregarded
27 Investors with net losses	(\$1,020,291)	(\$1,020,291)	(\$1,020,291)	\$1,020,291	\$557,584
55 Investors with net gains	\$19,975,880	\$0	(\$2,539,803)	\$0	\$1,269,902
Other Class 5 Claimants	(\$1,652,936)	(\$1,652,936)	(\$1,652,936)	\$1,652,936	\$826,468
Totals	\$17,302,653	(\$2,673,227)	(\$5,308,488)	\$2,673,227	\$2,654,244

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10 Assuming that approximately \$2.7 million is available for distribution to Class 5 (as indicated above),
11 then under Option 1, the investors who had a total of \$1.02 million in losses, and the other Class 5
12 Claimants who have valid claims of \$1.65 million under the Plan would each be paid 100% of their
13 claims. Under Option 2, approximately the same would be distributed in the aggregate (just under
14 \$2.7 million), but the investors who had net losses and the other Class 5 Claimants would only be
15 paid 50% of their claims, requiring about \$1.38 million. In that scenario, the remaining \$1.27 million
16 would be paid to 55 investors who collectively already have a total gain of nearly \$20 million from
17 the distribution of Successful Investments. Because Option 2 would result in giving claimants with
18 substantial gains even more funds, at the expense of making other claimants whole, the Receiver
19 believes that Option 1 is the more equitable method.

20 **IV. REMAINING PLAN ISSUES RESERVED FOR FUTURE DETERMINATION**

21 *A. Remaining Failed Investment Claims*

22 In the event that there is a surplus in the case following payment to the Class 1, 2, 3, 4 and 5
23 Claimants, the Receiver reserves the right to propose establishing a new Class for the Failed
24 Investment Claims other than the claims for Candi Controls and Practice Fusion. As set forth above,
25 the Receiver proposes that claimants in Candi Controls and Practice Fusion receive distributions
26 based upon the tax benefits their investment provided to the estate. Under that proposal, investors in
27 Candi Controls will receive an average of 71%, and Practice Fusion an average of 22%. In the
28 remaining Failed Investments other than Candi Controls and Practice Fusion (the “Remaining Failed

1 Investments”¹⁷), claimants invested a total of \$11.7 million, and the Court disallowed those claims
2 as investors’ losses were not attributable to the SRA managers’ malfeasance.

3 The Failed Investment Claims will have received no distribution whatsoever, so the Receiver
4 believes that consideration might be given to those claimants if there are available funds that could
5 serve as a source of payment for this class of Failed Investment Claimants. If Option 1 is utilized for
6 the calculation of the Investor Deficiency Claims, then there may be a surplus following distribution
7 to Class 5 which could be used to pay these claims. Additionally, the Receiver continues to hold over
8 half a million dollars in the Anne Bivona Funds in the estate, which have not been allocated to any
9 class; however, the SEC asserts the right to determine the ultimate disposition of these funds.

10 The Receiver is not yet proposing that the Anne Bivona Funds and any excess in the Plan
11 Fund be used to provide a distribution to the Remaining Failed Investments but provides this
12 information so that the Court can fully evaluate the consequences of selecting Option 1 or 2 for
13 calculation of the Deficiency Claims and possible options as to how to distribute any surplus funds.
14 If Option 1 is selected and surplus funds were paid to the Remaining Failed Investments, the Receiver
15 estimates that the Remaining Failed Investment Claimants would have at least a 5% distribution
16 depending on the amount of any such surplus, which is unknown at this time.

17 2. *Cilano Claim*

18 (a) Possible Surplus Funds

19 Joshua Cilano (“Cilano”) has asserted a claim against the estate (the “Cilano Claim”), and the
20 SEC has objected to that claim (Dkt. No. 572). In its Amended Order approving the Plan on May 25,
21 2020, the Court noted that it would defer resolution of the Cilano Claim until it could be determined
22 whether there would be surplus funds after the first five classes received full distribution. (Dkt. No.
23 613, ¶ 8). The outcome of this Motion will determine whether or not there will likely be a surplus of
24 funds available beyond payment to the existing five classes of claimants. If Option 1 for calculation
25 of the Deficiency Claims is selected and there are surplus funds available for distribution, it is
26

27 _____
28 ¹⁷ Specifically: Aliphcom DBA Jawbone, Badgeville, Inc., Glam Media, Inc., Jumio, Inc., Odesk
Corp., and Virtual Instruments Corp.

1 conceivable that some funds might be available for distribution to Cilano (and/or the Failed
2 Investment Claimants).

3 The crux of the Cilano Claim is that Cilano contends he is entitled to backend fees in the
4 amount of “10% of any profits Mr. Cilano’s clients made in SRA investments.” (Cilano Objection
5 Opp., Dkt. No. 590, at 1.) In his opposition to the SEC’s objection to his claim, Cilano stated that his
6 “clients were and are aware of this provision, and they fully support compensating Mr. Cilano
7 according to these agreed upon terms,” and that “none of Mr. Cilano’s clients have objected to his
8 claim for compensation.” (*Id.* at 1-2.) That 10% performance fee was calculated, however, as 50%
9 of the backend fees earned by SRA (*i.e.*, 50% of a 20% performance fee is equal to 10%), but the
10 receivership was created before any such fees were actually earned. The Receiver is advised that
11 there are 59 investors who were clients of Cilano (the “Cilano Clients”) and whom Cilano contends
12 owe him 10% of the gains on their investments.

13 (b) The Receiver’s Proposal

14 As an alternative to an adversarial proceeding as between the SEC and Cilano regarding the
15 Cilano Claim, the Receiver proposed a framework to the SEC and Cilano to resolve the Cilano Claim
16 via a compromise consistent with Cilano’s representations about his clients supporting payment of
17 fees to Cilano. The Receiver’s proposal also would not deplete the funds available for distribution
18 under the Plan to any claimant other than the Cilano Clients who opt-in to the proposal. As set forth
19 below, the Receiver notes that both the SEC and Cilano have declined to accept the Receiver’s
20 proposal which the Receiver suggested as a fair and cost-effective resolution to the objection to the
21 Cilano Claim.

22 The Receiver’s proposal is detailed as follows. The Cilano Clients are investors entitled to
23 distributions as Class 4 and 5 Claimants. The Receiver proposed that, to the extent that the Cilano
24 Clients expressly opt in to a distribution model that pays Cilano a percentage of their net gains,¹⁸ the
25 Cilano Claim can be paid from distributions otherwise going to the Cilano Clients. In other words, if
26

27 ¹⁸ The Receiver believes that the commission should be a 5% commission on net gains from the
28 Successful Investments in the receivership, rather than a percentage of back-end fees that SRA
would have charged based on the gains from an investment in a now-defunct SRA fund.

1 a Cilano Client opts in, and that client is to receive a distribution from the Class 4 Reserves, the
2 Receiver proposes to pay up to 5% of the Cilano Client's total gain to Cilano, and the balance would
3 be paid to the Cilano Client. If a Cilano Client does not opt in, nothing will be paid to Cilano on
4 account of the claim and the Cilano Client would be paid the full distribution owing in Class 4.

5 Such a proposal is in line with Cilano's assertion that the Cilano Clients agreed to pay Cilano,
6 but gives those investors the option to opt in or opt out. The payment to Cilano would technically not
7 be coming from the receivership estate, but rather the clients of Cilano would be affirmatively
8 agreeing to pay Cilano a commission from their distributions. The Receiver would merely facilitate
9 the process. The Receiver can cost-effectively administer this process by providing written notice to
10 the Cilano Clients of the opt in procedure and by calculating any amounts to be paid to Cilano in
11 connection with the distributions to be made under the Plan. The Receiver proposed to provide ninety
12 days' notice to the Cilano Clients of the opt in procedure by separate notice. The Receiver would
13 include the calculation of the payment to be made to Cilano in connection with a motion to approve
14 the final distributions and once the number of opt in Cilano Clients is known. Any distribution to be
15 made on the Cilano Claim would be subject to Court approval.

16 Under this method, the Cilano Claim would not be satisfied with any portion of the Plan Fund
17 or generally available funds – a portion of the Class 4 reserves would simply be paid to Cilano from
18 the Class 4 distributions to be paid to his clients for those clients who choose to opt into this proposal.

19 As noted above, neither the SEC nor Cilano have agreed to this proposal. Therefore, in the
20 alternative, the Receiver believes it is appropriate for the Court to establish a briefing schedule so
21 that the SEC can pursue its objection to the Cilano Claim.

22 (c) The SEC Objection and Discovery Proposal

23 The SEC objects to any distribution being paid to Cilano, as has been its view from the outset
24 of this litigation. In response to the Receiver's proposal, the SEC continues to object to Cilano
25 receiving any more money from the Receivership or the investors connected to this Receivership. To
26 the extent that the issues relating to the Cilano Claim become ripe as a result of this Motion, the SEC
27 has advised the Receiver that it believes that comprehensive discovery and an evidentiary hearing,
28

1 under oath, are necessary for evaluation of the Cilano Claim.¹⁹ The SEC has requested that, if the
 2 issue becomes ripe because there are surplus funds, and the Court is inclined to consider Mr. Cilano’s
 3 claim, the SEC respectfully requests the following discovery:

- 4 • Written discovery, including Requests for Production of Documents and Interrogatories;
- 5 • An in-person deposition of Mr. Cilano in San Francisco; and
- 6 • An evidentiary hearing before this Court during which the SEC and the Court may
 7 ask Mr. Cilano questions under oath.

8 The SEC proposes the following schedule for this discovery:

- 9 • The SEC would propound its written discovery within 30 days of the Court’s Order
 10 on this Motion;
- 11 • Mr. Cilano would have 30 days to respond to the written discovery and produce the
 12 requested documents;
- 13 • The SEC and Mr. Cilano would agree on deposition date within 60 days after the
 14 production of the documents and discovery responses have been completed;
- 15 • Within five days of the deposition, the parties will jointly propose dates between 45
 16 to 90 days later for an evidentiary hearing; and
- 17 • Within 14 days of the hearing, Mr. Cilano will file a brief not longer than 10 pages
 18 setting forth his position on the claim, and the SEC will have 14 days to respond.

19 **V. THE PROPOSED CHANGES ARE FAIR AND EQUITABLE**

20 The Court’s power to determine appropriate procedures for administering a receivership is
 21 “extremely broad.” *SEC v. Hardy*, 803 F.2d 1034, 1037 (9th Cir. 1986); *see also SEC v. Basic Energy*,
 22 273 F.3d 657, 668 (6th Cir. 2001); *SEC v. Elliott*, 953 F.2d 1560, 1566 (11th Cir. 1992). The “primary
 23

24 ¹⁹ The SEC’s position is based upon the Court’s May 25, 2020 Ruling on this issue (Dkt. 613, ¶ 8).
 25 In deferring the ruling on the SEC’s Claim Objection to the Cilano Claim, the Court held:

- 26 • If the Court determines to allow the Cilano Claim, it would be classified as a Class 6
 27 Claim that would be “subordinated in full to Classes 1 through 5”;
- 28 • If it appears there will be surplus funds after Classes 1 through 5 are compensated, the
 Court will examine:
 1. Whether Mr. Cilano has legal standing since he contracted with Alexander
 Capital, which had a contract with SRA Management; and
 2. Whether Mr. Cilano is truly non-culpable (“including, *inter alia*, the accuracy of
 his statement to prospective investors that SRA funds was the only way to invest in Palantir and
 other Silicon Valley entities.”).

The Court noted that it “may also make a determination regarding appropriate discovery.”

1 purpose of equity receiverships is to promote orderly and efficient administration of the estate by the
2 District Court for the benefit of creditors.” *Hardy*, 803 F.2d at 1038. As such, the Court has wide
3 latitude when it exercises its inherent equitable power to approve a plan of distribution of receivership
4 funds. *SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 331 (5th Cir. 2001) (affirming district court’s
5 approval of plan of distribution because court used its discretion in “a logical way to divide the
6 money”) (quoting *United States v. Durham*, 86 F.3d 70, 73 (5th Cir.1996)); *Quilling v. Trade*
7 *Partners, Inc.*, 2007 WL 107669, at *1 (W.D. Mich. 2007) (same). In approving a plan of distribution
8 in a receivership, “the district court, acting as a court of equity, is afforded the discretion to determine
9 the most equitable remedy.” *Forex*, 242 F.3d at 332. The Court may adopt any plan of distribution
10 that is logical, fair, and reasonable. *See, e.g., SEC v. Wang*, 944 F.2d 80, 83-84 (2d Cir. 1991); *Basic*
11 *Energy*, 273 F.3d at 671; *Quilling*, 2007 WL 107669 at *1.

12 The Receiver believes the proposed modifications to the Plan are logical, fair, and reasonable,
13 for several reasons:

14 *First*, the modifications properly allocate the costs and benefits associated with each specific
15 Publicly Traded Security to the subclass of claimants that actually invested in that such security. The
16 Plan had been structured to ensure that each Class 4 subclass of investors received their *pro rata*
17 share of the pool of assets supporting that subclass, after the Plan Fund contribution and the payment
18 of required taxes. Now that all the shares of each Publicly Traded Security have been sold or
19 distributed, and the actual tax returns with respect to the disposition of each of the Class 4 securities
20 have been received, the Receiver is in a position to allocate the Class 4 Reserves with more precision.
21 As such, the Receiver’s proposed modifications ensure as a matter of equity that each subclass
22 receives the benefit or bears the burden of the tax consequences associated with the securities in that
23 subclass.

24 *Second*, providing both the net proceeds and tax benefits to the Evernote Claimants allows
25 the Evernote Claimants to receive the estate’s net benefit of its holdings in Evernote shares, while
26 also assisting in bringing the receivership to a close. Given that the 30% Plan Fund contribution was
27 calculated based upon an investment becoming a Successful Investment, the sale of a stock for \$1
28 that had been purchased by claimants for an average of over \$13 per share (and for which the estate

1 had a basis of \$8 per share) would not warrant such a contribution. Because the Plan Fund also is the
2 source of the payment of Deficiency Claims, and the Evernote Claimants will receive substantially
3 more than \$1 per share if the entire Evernote Tax Reserve is distributed to them (if there are no as
4 yet unassessed taxes), it would not be equitable to allow for any additional distribution based on the
5 investors' deficiency in Evernote.

6 *Third*, because the failure of Practice Fusion and Candi Controls resulted in the investors in
7 those companies properly losing any right to receive a distribution of shares in those companies, it
8 would be inequitable for the estate to receive a windfall of nearly \$3 million due to the tax benefits
9 provided by those losses. As a matter of equity, those benefits should be given to the claimants who
10 had shares in those companies, on a *pro rata* basis as set forth in Exhibits "4" and "5" attached to the
11 Receiver's Declaration.

12 *Fourth*, the proposed method of calculating Class 5 Deficiency Claims is fair because it
13 clarifies the definition and calculation of a Deficiency Claim using a simple and workable method
14 based on value in and value out. Under the proposed clarification, a Class 5 Deficiency Claim is
15 simply the difference between the value that a Class 4 Claimant contributed to the Receivership
16 Entities for their Successful Investments, and the value that that Class 4 Claimant received from the
17 Receivership Estate for those Successful Investments, whether in distributions of cash or securities.
18 The Receiver's proposed method of calculating Class 5 Deficiency Claims attempts to ensure that as
19 many claimants as possible receive value in distributions equivalent to the value of their
20 contributions. And because Class 5 Claims are paid from the Plan Fund, the Receiver does not believe
21 it would be equitable to pay Deficiency Claims to investors who have already received more than
22 100% of the value they contributed with respect to their Successful Investments.

23 *Fifth*, allowing the Receiver to hold the Class 4 Reserves until the audit period has passed
24 will ensure that all taxes are paid. As the Plan already provided, the payments of required taxes are
25 considered Class 2 Claims, and that "no distribution will be made to Classes 3, 4 or 5 until such time
26 as Class 1 and 2 Claims have been paid in full or sufficient reserves are held to ensure payment in
27 full to Classes 1 and 2." (Plan at 11.) The proposed modifications simply implement that intent of
28 the Plan, by ensuring that all cash in the Receivership Estate is available to pay all Class 2 Claims.

1 Since a receiver may be held personally liable for unpaid federal income taxes pursuant to 31 U.S.C.
2 § 3713, it is imperative that the estate continues to hold these Reserves to fund any unanticipated tax
3 liability before any distributions are made. And if any such funds are needed, the Receiver will still
4 seek Court authority to determine which funds should be used in the interest of equity.

5 **VI. CONCLUSION**

6 For the foregoing reasons, the Receiver therefore requests that this Court (1) confirm that all
7 funds in the estate will remain available for Class 2 tax payments; (2) authorize the creation of
8 separate Class 4 Reserves for each Class 4 subclass, to contain the proceeds of the cash sales of such
9 security, less any contribution to the Plan Fund, plus any tax benefits and less any tax burdens arising
10 from the sale or distribution of such security; (3) authorize the Receiver to make the transfers of
11 funds to or from the Tax Holding Account necessary to create the Class 4 Reserves; (4) modify the
12 Distribution Plan to create subclasses 6A for Practice Fusion investors and 6B for Candi Control
13 investors, and to fund Evernote, Practice Fusion, and Candi Control Tax Reserves with the plan to
14 distribute any portion of those reserves not needed for as yet unassessed taxes to the respective 4F,
15 6A, and 6B subclasses; (5) confirm that Class 5 Deficiency Claims shall be the difference between
16 the value contributed by an investor for their Successful Investments in the aggregate and the value
17 received by that investor for those Successful Investments in the aggregate; and (6) authorize the
18 prosecution of the Cilano Claim and fix a briefing schedule for that proceeding. The Receiver
19 requests all other appropriate relief.

20
21 DATED: July 27, 2023

RAINES FELDMAN LITTRELL LLP

22
23 By: /s/ Kathy Bazoian Phelps

24 Kathy Bazoian Phelps
25 *Successor Receiver*
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27
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