IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	
	§	
v.	§	
	§	
DAVID RONALD ALLEN, et al.,	§	No. 3:11-cv-882-O
	§	
Defendants	§	
	§	
and	§	
	§	
PATRICIA ALLEN, et al.,	§	
	§	
Relief Defendants	§	

RECEIVER'S REQUEST FOR FIRST INTERIM DISTRIBUTION

Michael J. Uhl, the appointed receiver in this matter (the "Receiver"), respectfully requests that the Court authorize an initial distribution of recovered funds to investors harmed by the underlying *Ponzi* scheme in this case. While the Receiver anticipates some further recovery of funds, the bulk of the Receivership Estate appears to have been collected and is of sufficient size for a distribution to be made. As described herein, the Receiver proposes that the Court authorize a distribution to be made under a "rising tide" method.

I. The *Ponzi* Scheme

This case concerns a *Ponzi* scheme led by defendants David Ronald Allen, Christopher Mills, and Alex Dowlatshahi. A *Ponzi* scheme is a "fraudulent investment scheme in which money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments." PRELIMINARY INJUNCTION,

p. 4 (Doc. 58) (quoting *Janvey v. Alguire*, 628 F.3d 164, 176 (5th Cir. 2010)). The Security and Exchange Commission ("SEC") presented evidence to the Court that the individual defendants were using the defendant and relief-defendant entities as a *Ponzi* scheme to defraud investors. *Id*. at pp. 3-6. The evidence suggested that Allen, Mills, and Dowlatshahi created the various defendant/relief-defendant companies for a common *Ponzi* scheme and that funds were moved through and among them for the *Ponzi*. *Id*. at pp. 8-9.

Following an evidentiary hearing, the Court granted the Security and Exchange Commission's ("SEC's") request for a preliminary injunction. *Id*. The defendants thereafter entered consent judgments based on the claims in suit. *See, e.g.* Docket Nos. 126, 129, 132, 133, 170, 175, 176, 185, 208, 238, 242, 243, 252, and 253.

II. The Receivership Entities

Based on this scheme, the Court appointed the Receiver and placed a number of entities in receivership. Those entities include Associates Funding Group, Inc.; Associates Capital Leasing Joint Venture; Development Capital Associate Joint Venture; Community of Pleasant Ridge, Ltd.; Debt Management Associates, Ltd.; D-Cap II Partners, Ltd.; D-Cap III Partners, Ltd.; D-Cap IV Partners, Ltd.; D-Cap V Partners, Ltd.; D-Cap VI Partners, Ltd.; D-Cap VII Partners, Ltd.; D-Cap VIII Partners, Ltd.; D-Cap IX Partners, Ltd.; D-Cap X Partners, Ltd.; D-Cap XI Partners, Ltd.; D-Cap XII Partners, Ltd.; D-Cap XIII Partners, Ltd.; D-Cap XIV Partners, Ltd.; D-Cap XV Partners, Ltd.; D-Cap XVI Partners, Ltd.; D-Cap XVII Partners, Ltd.; Debt Management Associates LLC; Credit Money and Life Corp.; Imperalis Holding Corp.; Imperalis Media, LLC; Coloured (US) Inc.; and Prime Debt Services (hereafter "Receivership Entities"). (Docket Nos. 192 and 233.)

Additionally, the Court has charged the Receiver with distributing certain funds collected from Forex Community Partners Ltd. (hereafter "FCPL") (Docket No. 206). FCPL was not initially named as a defendant in this matter or as a receivership entity. FCPL's funds, however, were held by defendant Townhome Communities Corp. when the Court issued an injunction freezing the defendants' assets. (Docket No. 200). Thereafter, certain defendants asked the Court to unfreeze the FCPL funds so that such funds could be distributed to the FCPL investors in partial satisfaction of judgment. *Id*. The Court granted the motion in part by unfreezing the FCPL funds and placing them in the Court's registry for distribution. (Docket No. 206). The Court, however, denied the request to earmark such funds for distribution to FCPL-specific investors and instead charged the Receiver with determining the appropriate method of distributing said funds. *Id*.

Generally, a pooled distribution of funds, even from separate legal entities, is equitable when the separate entities were involved in a unified scheme to defraud. *SEC v. Amerifirst Funding, Inc.*, 2008 U.S. Dist. LEXIS 20044, *12 (N.D. Tex. 2008). Even if specific portions of the funds can be traced to specific investors, the Court is not required to distribute the funds to those investors specifically. *See, e.g. SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 331 (5th Cir. 2001); *United States v. Durham*, 86 F.3d 70, 72-73 (5th Cir. 1996). Further, even funds from separate legal entities should be consolidated together equitably where those entities were all involved in the allegations underlying the lawsuit. *Amerifirst Funding, Inc.*, 2008 U.S. Dist. LEXIS 2044 at *12.

Here the commingling of funds, unity of investors, and overlap of administrators counsel for including the FCPL funds in the general receivership estate. The Receiver's investigation has shown that FCPL was intertwined with the Receivership Entities and the underlying *Ponzi* scheme. FCPL was established during the *Ponzi* by Allen. FCPL was a vehicle for some investors who had received "returns" on their *Ponzi* investments to re-invest those funds. Thus, the FCPL investors are, with one possible exception, investors in the Receivership Entities. By taking their "returns" from the other Receivership Entities and re-investing them in FCPL, the FCPL investors comingled the defrauded investors' funds into FCPL. While there may be additional, non-*Ponzi* funds that the FCPL investors also invested in FCPL, tracing those specific funds would be unduly expensive and perhaps impossible.

The Receiver sees no equitable reason to treat the FCPL investors more favorably than the other defrauded investors. Accordingly, the Receiver proposes including the FCPL funds in the term Receivership Entities and in the proposed distribution method described herein.

III. Funds Available for Distribution

As the Receiver's Fourth Report describes, the Court's registry and the Receiver's currently contain approximately $1,167,000.00 for potential distribution to investors. (Docket. No. 325.) The receiver proposes that the Court authorize an initial distribution of $1,000,000. Such distribution will provide injured claimants with the bulk of the funds already recovered. It should also leave sufficient funds to cover any further expenses that the Receiver will incur in resolving this matter. Further, retaining some funds in the Receiver's account will not prejudice the Receivership Estate because a subsequent distribution will be required in any event to distribute the outstanding funds the Receiver continues to pursue.

The Receiver's investigation indicates a gross investment loss under the *Ponzi* scheme of $7,897,000. A total of $1,285,828.34 has been deposited in the Court's registry and the Receiver's account. The Court has already authorized payment of $118,491.51 in professional fees associated with the Receivership. (Docket Nos. 267, 310). The currently proposed

$1,000,000 distribution represents a 12.66% return on lost funds. That percentage will likely improve after a second distribution in which the Receiver can distribute any remaining funds in the Receivership Estate and any additionally collected funds.

IV. Potential Distribution Methods

Where, as here, the amount of purported claims of the investors exceeds the funds available for distribution to the claimants, a court must devise an equitable distribution system that treats the victims fairly and as nearly equally as possible. *U.S. v. Cabe*, 311 F. Supp. 2d 501, 504 (D.S.C. 2003). District courts have wide latitude when exercising their inherent equitable power in approving a distribution plan of receivership funds. *Amerifirst Funding, Inc.*, 2008 U.S. Dist. LEXIS 2044 at *8; *see also S.E.C. v. Capital Consultants LLC*, 397 F.3d 733, 738 (9th Cir. 2005); *SEC v. Basic Energy & Affiliated Resources Inc.*, 273 F.3d 657, 668 (6th Cir. 2001). A district court, acting as a court of equity, is afforded the discretion to determine the most equitable remedy. *Forex*, 242 F.3d at 332. Courts generally favor *pro rata* distributions of assets where the victims' funds are comingled and where the victims are similarly situated with respect to their relationship to the defrauders. *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88-89 (2d Cir. 2002). The absence of commingling, however, does not render a pooled, pro rata distribution inequitable. *Forex*, 242 F.3d at 331-32.

The struggle courts typically face in crafting a distribution method concerns how best to handle funds that an investor/victim has already received from a *Ponzi* scheme. As in this case, the receiver's funds are often insufficient to fully pay back the investors' losses. Further, many of the investors will already have received some funds back from the *Ponzi* scheme. Those "returns," however, completely or partially include money taken from other defrauded investors since by definition a *Ponzi* scheme uses the funds of later investors to pay or increase the return of earlier investors.

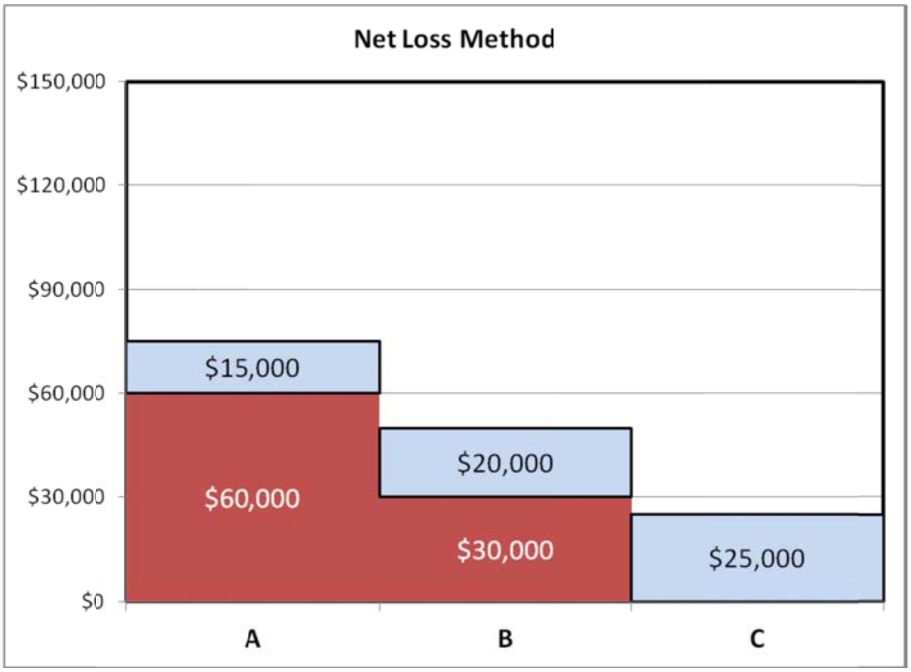
Courts typically employ two main methods to distribute receivership funds to investors in such cases: the "rising tide" method and the "net investment" (or "net loss") method. The two methods differ based on how they treat monies paid out to investors during the *Ponzi*. The net investment method calculates each investor's "net investment" in the *Ponzi* by subtracting the investor's return from the investor's total investment. That investors' net investment is then compared against the total amount of all investments to determine the investors' percentage of all investments. That percentage is then multiplied against the amount recovered by a receiver to determine what portion of the receiver's funds should be paid to the investor. The rising tide method, in contrast, first finds each investors' percentage of the entire investment pool by dividing the investor's actual dollars invested by the total amount invested by all investors. That percentage is then multiplied against the funds available for distribution and any profits previously received by the investor are subtracted.

In other words, the two methods can be expressed by the following formulas:

- Net Investment: ((Investor's Actual Dollars Invested minus Return Previously Received) divided by Aggregate Actual Amount Invested by all Investors) multiplied by (Amount Available for Distribution)
- Rising Tide: (Investor's Actual Dollars Invested divided by Aggregate Actual Amount Invested by all Investors) multiplied by (Amount Available for Distribution) minus (Return Previously Received).

These two distribution methods can have significantly different results for investors. Judge Posner recently evaluated the two methods in *SEC v. Huber*, 702 F.3d 903, 904-06 (7th Cir. 2012).

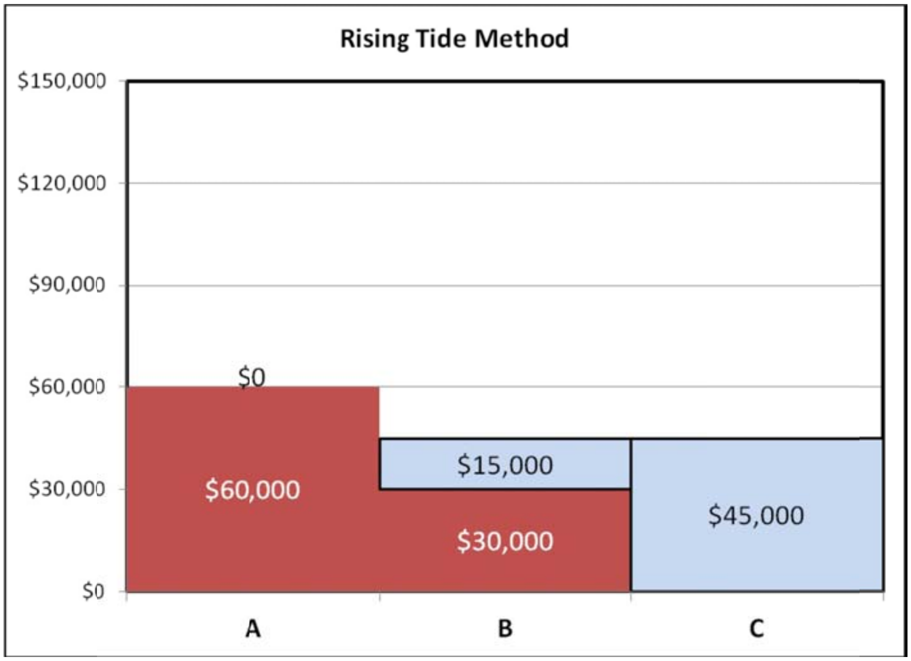
> To understand the difference between the two methods, imagine that three investors lose money in a Ponzi scheme. *A* invested $150,000 and withdrew $60,000 before the scheme collapsed, so his net loss was $90,000. *B* invested $150,000 but withdrew only $30,000; his net loss was $120,000. *C* invested $150,000 and withdrew nothing, so lost $150,000. Suppose the receiver gets hold of $60,000 in assets of the Ponzi scheme — one-sixth of the total loss of $360,000 incurred by the three investors ($90,000 + $120,000 + $150,000). We'll call these recovered assets "receivership assets." Under the net loss method each investor would receive a sixth of his loss, so *A* would receive $15,000, *B* $20,000, and *C*$25,000, as shown in the following chart; the pale blocks are the amounts received by the investors and the dark blocks are the withdrawals.



> Under the rising tide method, withdrawals are considered part of the distribution received by an investor and so are subtracted from the amount of the receivership assets to which he would be entitled had there been no withdrawals. (When there are no withdrawals, rising tide yields the same distribution of receivership assets as net loss.) In our example, the total of withdrawn plus receivership assets is $150,000 ($60,000 + $30,000 + $0 [the withdrawals] + $60,000 [the receivership assets]), but there is only the $60,000 in such assets to distribute. *A*, having been deemed (as a consequence of the rising tide approach)

to have "recovered" $60,000 before the collapse of the Ponzi scheme, is entitled to nothing from the receiver, as otherwise the remaining sum of withdrawals and receivership assets — a total of $90,000 ($30,000 in withdrawals, all by *B*, and $60,000 in receivership assets) — would be insufficient to bring the remaining investors up to anywhere near *A*'s level. For remember that under the net loss method each investor would have received the same fraction of receivership assets as his fraction of the loss, and thus *A* would have received $15,000, *B* $20,000, and *C* $25,000. The result, since under the rising tide method withdrawals are treated as compensation, is that *A* would have been "compensated" to the tune of $75,000 ($60,000 withdrawn + $15,000 in receiver assets), *B* $50,000 ($30,000 + $20,000), and *C* $25,000 (the balance of receiver assets, *C* having had no withdrawals).

For the "tide" to raise *B* and *C* as close to *A* as possible, *B* has to receive $15,000 in receiver assets, for a total "recovery" of $45,000, and *C* the remaining receiver assets, giving him $45,000 too. The division of withdrawals plus receiver assets is then 60-45-45, as shown in the next chart, versus 75-50-25 under the net loss method.



Id.

The Rising Tide method is the most commonly used and judicially approved method for apportioning receivership assets. *Id.* at 906 (citing cases). The Net Investment method is attractive in those cases where a large number of investors would receive nothing under the rising tide method. *Id*. Likewise, one court in this district found that the net investment method was superior where a case concerned an unusual characterization of interest payments as a return of principal and a very small ratio of those "payments" in comparison to the receiver's assets for distribution. *Amerifirst Funding, Inc.*, 2008 U.S. Dist. LEXIS 2044 at *17-18.

V. Proposed Distribution Method

In this case, the Receiver recommends that the Court follow the majority and authorize the Receiver to employ the rising tide method. Here, the Receiver's investigation has found a diverse category of investors who invested in the *Ponzi* scheme. The investors' funds were commingled and transferred amongst the *Ponzi* entities such that tracing any individual investors' funds would be literally impossible or so expensive/time consuming as to be functionally impossible. The investors at issue here have received differing amounts of money "payments" from the *Ponzi* scheme. A rising tide method, however, does not appear to leave a significant sum of investors without any distribution from the receivership estate.

The Receiver suggests that the Court's determination of an appropriate method in this case should turn on equitable principles and precedent as opposed to whether any particular method will be more or less beneficial to any particular investor. Oftentimes, investor objections to a particular distribution method are driven largely by a desire to reach the method that benefits that particular investor most. That is only natural in a case such as this where the recovered funds will not make all investors whole. Accordingly, the Receiver does not attach a schedule of particular returns due to particular investors to this Motion. Should the Court wish to see all or a sample of the specific payout calculations, the Receiver suggests that such information should be submitted for *in camera* review.

The Receiver, however, would inform the Court of a few key definitions that the Receiver proposes employing for the distribution calculation:

Claimants/Investors: Pursuant to the Court's Order Establishing Claim Procedure Plan (Docket No. 236), the Receiver has sent notifications to investor and non-investor claimants. The Receiver has collected and compiled the responses. Some responses were returned after the stated deadline. Notwithstanding that, the Receiver proposes allowing the late-submitted claims as there does not appear to be any harm to the Receivership Estate and/or claims process from any delinquency to date. The Receiver, however, proposes that no further claims be allowed after the submission of this Motion. Further, the Receiver has identified certain instances where multiple claims have been submitted by individuals having the same last name and giving the same mailing address. Where such claims appear to be duplicates of one another, the Receiver proposes removing the apparent duplicates. Where the claims appear to be multiple, but differing claims brought by a single household, the Receiver proposes combing the claims into one effective claimant.

Investment and Returns: Following the return of claim forms, the Receiver's investigator and accountant have attempted to verify the value of claims submitted by investors. To do so, the investigator and accountant have compared the submitted claims against a number of available sources of information, including:

- Expert report(s) and summaries of reports prepared by experts employed by the SEC in the preparation of the filings in this matter.
- Bank records from 23 accounts belonging to receivership entities, including also general ledger summaries from those accounts and schedules summarizing the activity in those accounts.
- Private Placement Memorandums, investor subscription agreements, and sales documents the Receiver has collected from various sources including investors, general partners of the DCAP entities and former employees of the Receivership entities.

- Documents provided to the Receiver by investors during interviews and submitted during the claims process.
- Documents provided in response to subpoenas issued by the Receiver. Such documents included banking records from North Dallas Bank & Trust regarding the demand deposit accounts for the receivership entities, Debt Management Associates LLC, Credit Money and Life Corp., Imperalis Holding Corp., Imperalis Media, LLC, Coloured (US) Inc., and Prime Debt Services.
- Documents discovered in the process of disposing of office space leased by receivership entities. These included emails, employee files, engagement agreements and documents kept in the daily operation of those entities.
- Tax returns from of the Receivership entities; K-1s from Receivership entities.

The Receiver's agents have generally employed K-1 forms submitted to the Internal Revenue Service as a baseline for analysis. The other documentation just described has been compared against those forms or employed where no K-1 form is available. Where the K-1 Forms and the claims differed, the Receiver has deferred to the K-1 form unless, in the exercise of the accountants' and experts' professional judgment, the Receiver's experts believe a reason exists to depart from such numbers. Further, where K-1 Forms do not exist, the other available information has allowed the Receiver's and accountants to evaluate and adjust where necessary the alleged investments and returns.

Following this process, the Receiver has identified 137 claimants to the receivership. Of those 109 are potentially eligible to receive a distribution under this first interim distribution. This first interim distribution represents approximately 18% of the loss amount approved after the claim process.

VI. Notice and Distribution Procedure

Following submission of this request to the Court, the Receiver will e-mail a copy to claimants who have provided an e-mail contact to the Receiver. The Receiver proposes that the

Court allow thirty days from this Motion's filing to allow comment from any claimants in this matter.

Once the claimants have had an opportunity to comment, and the Court has ruled on the distribution method it wishes to employ, the Receiver will seek transfer of any relevant funds from the Court's registry into the Receiver's trust account and begin making distributions to the any claimants who qualify under the Court's chosen distribution method.

VII. Conclusion

For the foregoing reasons, the Receiver respectfully requests that the Court authorize him to distribute $1,000,000.00 from the Receivership Estate to qualifying investors under the Rising Tide distribution method.

Respectfully submitted,

/s/ R. Ritch Roberts
R. Ritch Roberts
Texas Bar No. 24041794
rroberts@fhsulaw.com
Fitzpatrick, Hagood, Smith & Uhl LLP
2515 McKinney Avenue
Suite 1400
Dallas, TX 75201
Tel. 214-237-0900
Fax. 214-237-0901

ATTORNEY FOR RECIEVER MICHAEL J. UHL

CERTIFICATE OF SERVICE

Undersigned counsel certifies that a conference on the foregoing motion and the items presented therein was held with counsel for the SEC. The SEC does not oppose the relief requested herein.

/s/ R. Ritch Roberts ____________________
R. Ritch Roberts

CERTIFICATE OF SERVICE

I hereby certify that, on December 8, 2014, I caused service of the above and foregoing instrument via filing with the Court's CM/ECF system

/s/ R. Ritch Roberts ____________________
R. Ritch Roberts