

seeks to have the entirety of the Estate used to pay outstanding professional fees of the Receiver and his counsel (collectively, the “Estate professionals”).¹

The Commission staff respectfully requests that before such a final disbursement of Estate assets occurs, notice be provided to interested parties, including investors and tax authorities, to ensure that any objections are heard and unknown claims are ascertained and addressed. In addition, rather than disbursing the entire Estate to the Estate professionals, thereby effectively nullifying any benefit to the Estate provided by those professionals, the Commission staff proposes that the remaining assets of the Estate be divided between outstanding professional fees and defrauded investors. Although the percentage of losses returned to investors would not be sizable, preliminary analyses indicate that the proposed distribution could result in the issuance of checks at or exceeding \$1,000 to more than fifty investors. Such a result balances the interests of the generally unsophisticated investors who were victims of the fraud with those of the Estate professionals who entered into this engagement fully aware of the limited assets in the Estate,² recognized in each fee petition the possibility of

¹ Docket No. 322 at 10.

² *See, e.g.*, Docket No. 28 (Plaintiff’s Motion to Establish a Receivership Estate and to Appoint a Receiver), Memorandum at p. 2 (“Given the lack of readily evaluated and distributable assets, but the potential for recovery from unevaluated assets, the Commission believes it to be in the best interest of defrauded investors to appoint a Receiver to protect, secure, and evaluate existing assets... [after which] the Receiver would then advise the Court and the Commission staff what approach, if any, is most likely to yield sufficient assets for distribution to defrauded investors.”).

not getting paid,³ and made an explicit recommendation each quarter to continue the Receivership notwithstanding the limited recoveries.⁴

Background

The fraud at issue in this action is described more fully in the Plaintiff's Motion for Partial Summary Judgment Against the Defendants and supporting memorandum (Docket Nos. 149, 149-1), and the Plaintiff's Motion for a Final Judgment and supporting memoranda (Docket Nos. 284, 284-1, 288). It involved 274 investors defrauded of more than \$16.1 million. On September 8, 2010, the Commission filed a Motion to Appoint Receiver and Establish a Receivership Estate (the "Receiver Motion").⁵ On September 13, 2010, this Court granted the requested relief, establishing the Estate and appointing the Receiver and counsel.⁶

At the outset, the Estate did not have substantial liquid, or readily liquidated, assets.⁷ Since the inception of the Receivership, the Receiver has marshaled for the Estate more than \$1.6 million in assets.⁸ At least 71% of the assets marshaled since the appointment of the Receiver have been obtained from third parties. Predictably, such efforts have not been without

³ See, e.g., Docket No. 310 (Receiver's Ninth Quarterly Fee Application) at ¶ 9 and note 3 (acknowledging that unbilled fees and expenses, and holdbacks, may not be paid out, depending on the Receiver's success in recovering assets for the Receivership Estate and/or Court approval).

⁴ See, e.g., Docket No. 308 (Thirteenth Quarterly Status Report of Kamian Schwartzman, Court Appointed Receiver), at p. 10 ("... based on his continuing belief that there remain pending and potential claims and assets that may result in recoveries sufficient to justify a distribution to defrauded investors, the Receiver recommends that the Court order the continuation of the Receivership Estate.")

⁵ Docket No. 28.

⁶ Docket Nos. 29, 30.

⁷ Docket No. 28-21 at p.2.

⁸ See Exhibit A to the Ninth Fee Petition.

cost to the Estate, and the Estate professionals have filed nine prior fee petitions, as a result of which the Receiver received aggregate professional fee payments to date of \$152,703, and his counsel received \$538,892. In connection with these petitions, they voluntarily accepted holdbacks of 55% and 72%, respectively. Of the more than \$1.6 million of assets that the Receiver marshaled, to date, defrauded investors have received none. The Estate currently consists of \$673,938.94 in assets. Expenses, including those associated with an expert witness used in certain ancillary litigation, are approximately \$250,000. By the Receiver's Application, the remaining assets, approximately \$420,000, would be used to offset outstanding professional fees of \$187,761.30 incurred by the Receiver, and \$1,414,730.50 incurred by his counsel.

The SEC's Proposed Alternative to the Relief Sought in the Application

The staff proposes to submit a distribution plan through a motion for an order to show cause ("OSC"), and if granted, disseminate the OSC and proposed plan to all known interested parties through a public website and through mailings to last known addresses. Through this process, investors, tax authorities, and any other known (and potentially unknown) creditors would be given a period during which to submit comments or objections to the staff. The staff would then address these comments and directions in a filing with the Court, attaching a final proposed plan.

Based on currently known claims against the Estate, the Commission staff anticipates submitting a proposed distribution plan in which the Estate, after payment of outstanding expenses would be divided equally between two groups: investors and the Estate professionals.⁹

⁹ The proposed distribution would be based on the information currently known and/or of record, without any additional discovery or claims process. Rather, any dispute of amounts due would be resolved through a comment period. Notwithstanding, prior to filing this response, the staff sought some additional information from certain third parties, the response to which it believes will be provided to it

Within each group, the Commission staff would propose a “Rising Tide” *pro rata* distribution. *See, e.g. C.F.T.C. v. Lake Shore Asset Management Limited*, 07-C-3598, 2010 U.S. Dist. LEXIS 24061, * 24 (N.D. Ill. March 15, 2010), *aff’d*, 646 F.3d 401 (7th Cir. 2011) (discussing the Rising Tide methodology). By this methodology, if a distribution participant already received a percentage of their loss greater or equal to that which would be distributed to other participants in their respective group, that participant would not receive any additional distribution. *Id.* at *25. As currently assessed, this methodology will ensure the most equitable distribution.

Under the staff’s proposed alternative, the distribution would be conducted jointly by the Commission staff and a Court appointed Distribution Agent and Tax Administrator (with the cooperation of the Receiver). The Commission staff would draft the proposed plan and schedules of distribution, as well as any accompanying motions or orders to show cause; publicize and disseminate the proposed plan to known interested parties for objection or comment; address any objections or comments; and provide a final accounting to the Court. Once a distribution plan is approved, the Distribution Agent and Tax Administrator would perform *ad hoc* address searches when needed; issue checks; and address any tax issues, including the preparation of tax returns, and a final tax return for the Estate. Additional expense to the Estate should be minimal.¹⁰

over the next few weeks. After receipt of the requested information, or confirmation that the information is not forthcoming, the staff hopes to be in a position to file the proposed distribution plan.

¹⁰ The staff has discussed the matter with an entity that can perform the Distribution Agent and Tax Administrator functions and, based on current information, the staff anticipates that the costs of such distribution and the compliance with Estate tax obligations, assuming no outstanding tax liability, will not exceed \$12,000.

Law and Argument

The amount of compensation to be awarded a court-appointed receiver is within the Court's discretion. S.E.C. v. Byers, 590 F. Supp. 2d 637, 644 (S.D.N.Y. 2008); *see also* United States v. Code Products Corp., 362 F.2d 669, 673 (3d Cir. 1966). Factors for consideration in determining compensation include the “time, labor and skill required, but not necessarily that actually expended, in the proper performance of the duties imposed by the court upon the receivers, the fair value of such time, labor and skill measured by conservative business standards, the degree of activity, integrity and dispatch with which the work is conducted and the result obtained.” Code Products 362 F.2d at 673, *quoting* Coskery v. Roberts & Mander Corp., 200 F.2d 150, 154 (3d Cir. 1952). *See also* SEC v. Illarramendi, Civ. Act. No. 3:11CV78 (JBA), 2013 U.S. Dist. LEXIS 171950, *8 (D. Ct. Dec. 6, 2013) (the cost efficiency of the receiver’s work, the complexity of the problems faced, the benefits to the receivership estate, the quality of the work performed, and the time records presented). The result obtained is a critical factor to be considered. Code Products, 362 F.2d at 673. The SEC’s position on the fee application will be given great weight. Byers, 590 F.Supp.2d at 644.

As district courts routinely hold, the staff is mindful of the importance of protecting some amount of assets for distribution to harmed investors (especially where they will only receive a fraction of their losses) even if it means limiting the return of professional fees. *See* SEC v. Northstar Asset Management, 05 Civ. 2192 (WHP), 2009 U.S. Dist LEXIS 89947, *5-*6, *16 (S.D.N.Y. Sept. 29, 2009) (in a matter in which professional fees approached the Estate’s value, and in which a considerable amount previously paid was clawed back from counsel, the Court substantially reduced the current request for fees); SEC v. Goren, 272 F. Supp. 2d 202, 213 (E.D.N.Y. 2003) (expressing concern where attorney fees represented a very large percentage of

the Estate, thereby foreclosing any meaningful distribution, and reducing that percentage to less than 30%, premised on reductions on inefficiencies and billing deficiencies). *See also* Byers, 590 F. Supp. 2d at 648 (where the court substantially reduced requested professional fees where the benefits of the receiver's work was not yet known, leaving open application for the cut fees when benefits known); SEC v. Cobalt Multifamily Investors I, Inc., 542 F. Supp. 2d 277, 281 (S.D.N.Y. 2008) (where the Court deferred ruling on fee petitions that would drain the Estate until review of a proposed plan of distribution).

In the present case, the staff does not take issue with the Estate professionals' work or billing practices. However, the fundamental purpose of this effort was to assist the Court in gathering and preserving assets with an eye to distribution to defrauded investors.¹¹ Indeed, if the Receiver's Application is granted, the Receiver will have provided no benefit to the Estate; only the Estate professionals would receive the benefit of his activities. This result would be unfair, especially where a distribution to investors is feasible and defrauded investors would tangibly benefit as a result. The investors in this matter invested their funds with no knowledge of the fraud or a shortage of assets from which to be paid. By contrast, the Receiver and his Counsel entered into this engagement fully aware of the limited assets in the Estate, repeatedly acknowledged the possibility of not getting paid, and recommended quarterly that the Receivership continue its efforts, notwithstanding the limited recoveries and their fee shortfall. On balance, the Commission staff respectfully submits that the equities lie with, at minimum, division of the net Estate as proposed herein to address these competing claims.

¹¹ *See* Docket No. 29.

Further, because the Application would result in the Estate's final disbursements before winding down,¹² the Commission staff respectfully submits that proceeding by way of an order to show cause and a proposed distribution plan will allow the Court to make a fully informed judgment. *See SEC v. Global Online Direct, Inc.*, 1:07-CV-0767-WSD, 2007 U.S. Dist. LEXIS 88819 (N.D. Ga. Nov. 29, 2007) (discussing the necessity of adequate notice and the opportunity to be heard by persons affected). It will ensure that the Court, the staff, and the Receiver are aware of all competing claims, including any due to tax authorities, and address them as appropriate in a final plan. *See* 31 U.S.C. 3713(a), (b) (governing the priority of claims of the United States Government, and the liability of a Receiver for unpaid claims of the Government).

Accordingly, the staff respectfully requests that this Court deny the Receiver's Application and permit the staff the opportunity to submit a plan of distribution to the Court as further described above.

Dated: November 7, 2014

Respectfully submitted,

s/ Catherine E. Pappas
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¹² *See* Docket No. 319 (Fifteenth Quarterly Status Report) at p. 9 (the Receiver does not see a net benefit in continuing the Receivership Estate and requests a quarter to wind down operations).

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

ROBERT STINSON, JR., et al.

Defendants, Relief Defendants.

Civil Action No. 10-cv-3130-BMS
CERTIFICATE OF SERVICE

CERTIFICATE OF SERVICE

The foregoing document has been filed electronically and is available for viewing and downloading from the ECF system. I do hereby certify that on November 7, 2014, I caused a true and correct copy of the foregoing document(s) to be served on the following and in the manner indicated below:

<p>Robert S. Stinson, Jr., Register #02584-015 First Commonwealth Service Company IA Capital Fund, LLC Keystone State Capital, Corporation Life's Good, Inc. Life's Good Capital Growth Fund, LLC Life's Good High Yield Mortgage Fund, LLC Life's Good STABL Mortgage Fund, LLC FCI GILMER FEDERAL CORRECTIONAL INSTITUTION P.O. BOX 6000 GLENVILLE, WV 26351 (via first class mail)</p>	<p>Christine A. Stinson (via electronic mail) Castinson7@gmail.com</p>
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