

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

EMANUEL L. SARRIS, SR. and

SARRIS FINANCIAL GROUP, INC.

Defendants.

Civil Action No.
12-4272-TON

SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM
IN SUPPORT OF ITS MOTION FOR AN ORDER ESTABLISHING A FAIR FUND,
APPROVING A DISTRIBUTION PLAN,
AND APPOINTING A DISTRIBUTION AGENT

The Securities and Exchange Commission (the "SEC") respectfully submits this Memorandum in support of its motion for an Order establishing a Fair Fund, approving the proposed Distribution Plan attached as Exhibit A (the "Plan"), and appointing the undersigned, a Commission employee, as distribution agent (the "Motion").

Prior to filing this motion, the SEC sent the Investor Notice, in the form attached as Exhibit B (the "Investor Notice") to all known Investors¹ at their last known address, and posted a copy of the Investor Notice on its public webpage for this matter:

<https://www.sec.gov/divisions/enforce/claims/sarris.htm>. The Investor Notice, among other things, alerted Investors of the SEC's intent to file this motion and of the methodology to be used in the Plan; informed Investors of the SEC's calculation of their Investment(s) and

¹ Capitalized terms not defined in this memorandum are defined in the Plan.

Recovery(ies); provided directions on how to object to the Plan, as well as to the SEC's preliminary calculation of Investment(s) and Recovery(ies); requested from certain Investors a completed questionnaire, updating payment information, and, as appropriate, completion of a tax form; and provided information concerning the tax consequences of distributions in this matter. As discussed below, five investors submitted objections and/or questions regarding the SEC's calculations, all of which have been resolved. Accordingly, the SEC now requests that this Court enter the proposed Order submitted with the Motion.²

I. BACKGROUND

A. The SEC Action

On July 27, 2012, the SEC filed a complaint in this Court against Defendants Emanuel L. Sarris, Sr. ("Sarris") and Sarris Financial Group, Inc. ("SFG") (collectively, the "Defendants") for violation of the federal securities laws. The SEC alleged, among other things, that from 2001 through 2009, the Defendants facilitated a Ponzi scheme by inducing over 70 individuals to invest over \$30 million in private funds that purportedly traded in foreign currencies, called the "Kenzie Funds." Dkt. No. 1. The SEC alleged that the Kenzie Funds were in fact a Ponzi scheme, with the majority of Investor funds used to pay redemptions to other investors, management and incentive fees, and operating costs of the entities involved in the scheme.

On January 26, 2016, the Court entered a Final Judgment as to the Defendants. The Final Judgment, to which the Defendants consented, required the Defendants, jointly and severally, to pay a civil penalty of \$380,000. The Defendants have since paid the civil penalty in full. *See* Dkt. No. 38. Pursuant to the Final Judgment, the SEC holds these funds pending further Order

² The SEC staff contacted John Grugan, Esq. regarding the relief sought in the Motion, who has informed the staff that he no longer represents the defendants. As reflected on the Certificate of Service, the SEC has sent a copy of the Motion and the accompanying papers directly to Mr. Sarris.

from the Court and may propose to the Court a plan to distribute the funds pursuant to the Fair Fund provisions of Section 308(a) of the Sarbanes Oxley Act of 2002, 15 U.S.C. §7246(a) (“Section 308(a”). Dkt. No. 34. By the Motion, the SEC requests an Order permitting such distribution.

B. The Fund

The SEC currently holds approximately \$385,000 in an interest-bearing account at the U.S. Treasury’s Bureau of Fiscal Service (“BFS”), comprised of the civil penalty paid by the Defendants and accrued interest (the “Fund”). Other than accrued interest, the SEC does not expect any additional funds. As discussed below, because the Fund includes a civil penalty, the SEC requests the establishment of a Fair Fund so that the Fund can be distributed.

On December 22, 2017, this Court appointed Miller Kaplan Arase LLP, a certified public accounting firm with an office in San Francisco, California, as Tax Administrator to execute all income tax reporting requirements of the Fund. Dkt. No. 42.

C. Harmed Investors and Aggregate Losses

The SEC has identified over 150 investors induced by the Defendants to invest in the Kenzie Funds (the “Investors”), approximately 130 of whom lost an aggregate of more than \$32 million (the “Harmed Investors”).

D. The Investor Notice and the Resolution of Investor Objections

On August 19, 2019, the SEC sent the Investor Notice to all Investors at their last known address and posted it on its public website. The Investor Notice, among other things, assigned to each Investor an Investor Number;³ alerted Investors of the SEC’s intent to file this motion and of the methodology to be used in the Plan; informed Investors of the SEC’s calculation of their

³ Investors were assigned an Investor Number in order to identify them while still protecting their privacy in, for instance, public filings.

Investment(s) and Recovery(ies); provided directions on how to object to the Plan, as well as to the SEC's preliminary calculation of Investment(s) and Recovery(ies); requested from certain Investors a completed questionnaire, updating payment information, and, as appropriate, completion of a tax form; and provided information concerning the tax consequences of distributions in this matter. Objections and responses to the Investor Notice were due within thirty days of the Notice, or September 19, 2019.⁴

In response to the Investor Notice, five investors (Investor numbers 28, 29, 40, 66, and 90) contacted the SEC with questions about their Investments and Recovery. The SEC discussed with each the calculations, in some cases adjusting its calculations of Investment(s) and Recovery(ies), and all objections have been resolved. The revised list of Investor Investment(s) and Recovery(ies) is attached as Exhibit C.

II. THE PROPOSED DISTRIBUTION

A. The Plan

In the Plan, the SEC proposes using the "Rising Tide" methodology to calculate Distribution Payments because some Harmed Investors Recovered a significant percentage of their Investments, whereas others Recovered none, or very little, of their Investment. *See* Exhibit C. Under the Rising Tide methodology, anyone who has previously Recovered a significant percentage of their Investment will not get a distribution until those who have little or no

⁴ Subsequent to sending the Investor Notice, the SEC attempted to locate and contact Investors whose Investor Notice was returned or who were required to, but did not, respond to the Investor Notice, through the use of commercial databases regularly available to the Division of Enforcement of the SEC. Despite these efforts, five Investors (Investor numbers 14, 71, 77, 89, and 92) failed to provide to the SEC information necessary to include them in a distribution under the Plan. If further attempts to contact these Investors are unsuccessful, they will be considered Unresponsive Investors as that term is defined in the Plan, and they will not be eligible for a distribution under the Plan.

Recovery recoup the same percentage (the “Recovery Ratio”). This is the most equitable approach in a situation like that at bar, in which the Fund is less than 1.2% of losses.

In this case, assuming \$370,000 available for distribution after Administrative Costs, and aggregate net losses of \$32 million, the SEC estimates a Recovery Ratio of approximately, 3%, meaning that all Harmed Investors have Recovered, or will Recover through this distribution, at least 3% of their Investment.⁵ Based on the current calculations, this will result in distributions to approximately 79 Investors (“Eligible Harmed Investors”) ranging from \$44 to \$29,000.

As an example of the application of the Rising Tide methodology, compare an Investor who Recovered 2.9% of their Investment (Investor A) of \$200,000 with an Investor who Recovered 1% of their investment of \$200,000 (Investor B). As demonstrated in the chart immediately below, under the Rising Tide methodology, both Investor A and Investor B will Recover 3% of their Investment, Investor A through a Distribution Payment of \$200, and Investor B through a Distribution Payment of \$4,000. A Harmed Investor who Recovered more than 3% would *not* receive a Distribution Payment until all other Harmed Investors have Recovered at least 3% of their Investment.

⁵ The amount available for distribution, the Recovery Ratio, and Distribution Payments are based on a conservative estimate of Administrative Costs and will change upon the Tax Administrator’s calculation of a final reserve and the final balance in the Fund after divestment.

(Line)	Investor A		Investor B	
1	Investment In	\$ 200,000.00	Investment In	\$ 200,000.00
2	Recovery Ratio	3.00%	Recovery Ratio	3.00%
3	Amount Necessary for 3% Recovery (Line 1*Line 2)	\$ 6,000.00	Amount Necessary for 3% Recovery (Line 1*Line 2)	\$ 6,000.00
4	Recovery	\$ 5,800.00	Recovery	\$ 2,000.00
5	Percent Recovered (Line 4/ Line 1)	2.90%	Percent Recovered (Line 4/ Line 1)	1.00%
6	Distribution Payment (Line 3-Line 4)	\$ 200.00	Distribution Payment (Line 3-Line 4)	\$ 4,000.00
7	Final Percent Recovered with Distribution Payment	3.00%	Final Percent Recovered with Distribution Payment	3.00%

The SEC alternatively considered a methodology commonly referred to as the Net Loss methodology, which first offsets an Investor's Investment by the Investor's Recovery to get their Net Loss, and then divides the Net Fair Fund *pro rata* among all Harmed Investors with a Net Loss. Based on the assumed distributable amount of \$370,000, and aggregate Net Losses of \$32 million, the *Pro Rata* Percentage ($370,000/32,000,000$) would be 1.16%. Again using Investors A and B for example and as reflected on the chart immediately below, use of this methodology would result in Investor A Recovering 3.38% of their Investment, and Investor B Recovering only 2.17%. The SEC rejects this approach as inequitable, disfavoring those Harmed Investors with lower Recoveries.

(Line)	<u>Investor A</u>		<u>Investor B</u>	
1	Investment In	\$200,000	Investment In	\$200,000.00
2	Recovery	\$4,350.00	Recovery	\$2,000.00
3	Net Loss (Line 1- Line 2)	\$195,650.00	Net Loss (Line 1- Line 2)	\$198,000.00
4	Pro Rata Percentage (distributable amount/ aggregate Net Losses)	1.16%	Pro Rata Percentage (distributable amount/ aggregate Net Losses)	1.16%
5	Distribution Payment (Line 3 * Line 4)	\$2,269.54	Distribution Payment (Line 3 * Line 4)	\$2,296.80
6	Total Recovery with Distribution Payment	\$6,619.54	Total Recovery with Distribution Payment (Line 2 + Line 6)	\$4,296.80
7	Final Percent Recovered with Distribution Payment	3.38%	Final Percent Recovered with Distribution Payment	2.17%

B. The Distribution Agent and Administrative Costs

In order to minimize administrative costs, the SEC proposes that Catherine E. Pappas, Senior Adviser in the SEC's Division of Enforcement, act as Distribution Agent for the Fund. In the absence of distribution agent costs, the SEC expects Administrative Costs will include only taxes, tax administration fees and costs, and costs of investment while held at BFS.⁶

III. THIS COURT SHOULD GRANT THE RELIEF REQUESTED

As a preliminary matter, the SEC moves this Court to establish a Fair Fund so that the collected civil penalty can be distributed to Eligible Harmed Investors. *See* 15 U.S.C. § 7246(a); *see also* the Final Judgment, Dkt. No. 34. Section 308(a) provides, in relevant part:

If in any judicial or administrative action brought by the [SEC] under the securities laws, the [SEC] obtains a civil penalty against any person for a violation of such laws, or such person agrees, in settlement of any such action, to such civil penalty, the amount of such civil penalty shall, on the motion or at the direction of

⁶ In a further effort to minimize Administrative Costs and, in particular, the annual costs of tax administration, the Plan provides that no checks will be issued or reissued after December 31, 2020. Plan, ¶ 13, subject to ¶¶ 14, 17.

the [SEC], be added to and become part of a disgorgement fund or other fund established for the benefit of the victims of such violation.

15 U.S.C. § 7246(a). The SEC brought this action under the federal securities laws and this Court has ordered payment of a civil penalty. Section 308(a)'s requirements have thus been satisfied and this Court should establish a Fair Fund comprised of the civil penalty collected in this case, plus any accrued interest; without such action, the SEC will be unable to distribute the funds collected.

The SEC further moves this Court to approve the Plan as the mechanism by which the Fund can be distributed. A district court has broad discretion in approving an SEC plan of distribution, and that determination is reviewed for abuse of discretion. *SEC v. Infinity Group Co.*, 226 Fed. Appx. 217, 218 (3d Cir. 2007). *See also SEC v. Quan*, 870 F.3d 754 (8th Cir. 2017); *SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 332-33 (7th Cir. 2010); *SEC v. Malek*, 397 Fed. Appx. 711, 715 (2d Cir. 2010), *citing SEC v. Loewenson*, 290 F.3d 80, 87 (2d Cir. 2002); *WorldCom, Inc. v. SEC*, 467 F.3d 73, 84 (2d Cir. 2006). The job of the district court is to ensure that the proposed plan of distribution is fair and reasonable. *See Quan*, 2017 U.S. App. LEXIS 16663, *16; *Wealth Mgmt.*, 628 F.3d at 332; *WorldCom*, 467 F.3d at 83-85 (because the SEC is fulfilling a statutory role in determining how to distribute recovered funds to investors, it is entitled to the deference of a “fair and reasonable” standard—that the plan fairly and reasonably distributes limited funds among the potential claimants).

In this case, the SEC proposes using a “Rising Tide” methodology to ensure that those Harmed Investors who have Recovered a substantial percentage of their Investments do not get additional funds through this distribution until those who have Recovered little or none of their Investment receive some of their Investment back. No Harmed Investor who Recovered more than the Recovery Ratio will receive compensation until all Harmed Investors have Recovered at

least that percentage of their Investment. The SEC believes this methodology to be the most fair and reasonable approach to distribution under the circumstances here—limited funds and Harmed Investors with varying Recoveries. *See SEC v. Huber*, 702 F.3d 903, 906 (7th Cir. 2012) (Posner, J.), and the cases cited therein (finding the Rising Tide methodology most commonly used and judicially approved for apportioning receivership assets); *CFTC v. Mason*, Civ. Act. No. 3:13-196-GCM, 2014 U.S. Dist. LEXIS 147770, *3-*8 (W.D.N.C. Oct. 14, 2014) (describing alternative calculations and finding the “rising tide” methodology most equitable where funds insufficient to make investors whole, preventing “a customer who previously received funds... from benefitting at the expense of other investors...”). Investors were provided with an opportunity to object to the chosen methodology through the Investor Notice (see Exhibit B); the SEC received no objection to the use of this methodology.

Finally, the SEC moves this Court to appoint the undersigned, Catherine E. Pappas, an SEC employee, as Distribution Agent to perform such functions as are necessary to implement and administer the Plan, including coordinate with the Tax Administrator to ensure compliance with applicable tax laws. As set forth in the Plan, the Distribution Agent, an SEC employee, shall receive no compensation other than her regular salary for her services in administering the Fund. The appointment of an SEC employee will expedite the distribution process and avoid the costs and expenses that would ordinarily be incurred by the appointment of a third-party administrator, thus maximizing return to Eligible Harmed Investors.

IV. CONCLUSION

For the reasons set forth above, the SEC respectfully requests that the Court grant the requested relief.

Respectfully submitted,

/s/ Catherine E. Pappas
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Dated: December 10, 2019

Exhibits:

- A. Proposed Plan
- B. Redacted Investor Notice
- C. Revised Exhibit A from Investor Notice