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11
12 **UNITED STATES DISTRICT COURT**
13 **CENTRAL DISTRICT OF CALIFORNIA**

14 **WESTERN DIVISION**

15 SECURITIES AND EXCHANGE
COMMISSION,

16 Plaintiff,

17 v.

18 WORLD CAPITAL MARKET INC.;
WCM777 INC.; WCM777 LTD. d/b/a
19 WCM777 ENTERPRISES, INC.; and
MING XU a/k/a PHIL MING XU,

20 Defendants,

21 KINGDOM CAPITAL MARKET, LLC;
22 MANNA HOLDING GROUP, LLC;
MANNA SOURCE
23 INTERNATIONAL, INC.;
WCM RESOURCES, INC.; AEON
24 OPERATING, INC.; PMX
JEWELS, LTD. TOPACIFIC INC.;
25 TO PACIFIC INC.; VINCENT J.
MESSINA; and INTERNATIONAL
26 MARKET VENTURES,

27 Relief Defendants.

Case No. CV-14-2334-JFW-MRW

**NOTICE OF MOTION AND MOTION
FOR ORDER:**

**(A) SUSTAINING OMNIBUS AND
SPECIFIC OBJECTIONS TO
CLAIMS;**

**(B) APPROVING PROPOSED
ALLOWED AMOUNTS OF CLAIMS;**

**(C) APPROVING DISTRIBUTION
PLAN AND AUTHORIZING
RECEIVER TO MAKE INTERIM
DISTRIBUTIONS;**

**MEMORANDUM OF POINTS AND
AUTHORITIES**

Date: November 28, 2016

Time: 1:30 p.m.

Ctrm: 16-Spring St. Floor

Judge: Hon. John F. Walter

1 **TO ALL INTERESTED PARTIES:**

2 **PLEASE TAKE NOTICE** that on November 28, 2016, at 1:30 p.m. in
3 Courtroom 16 of the above-entitled Court, located at 312 North Spring Street,
4 Los Angeles, California 90012, Krista L. Freitag ("Receiver"), the Court-appointed
5 permanent receiver for Defendants World Capital Market Inc.; WCM777 Inc.;
6 WCM777 Ltd. d/b/a WCM777 Enterprises, Inc.; and Relief Defendants Kingdom
7 Capital Market, LLC; Manna Holding Group, LLC; Manna Source
8 International, Inc.; WCM Resources, Inc.; ToPacific Inc.; To Pacific Inc.; and their
9 subsidiaries and affiliates, will and hereby does move the Court for an order
10 (A) Sustaining Omnibus and Specific Objections to Claims; (B) Approving
11 Proposed Allowed Amounts of Claims; and (C) Approving Distribution Plan and
12 Authorizing Receiver to Make Interim Distributions ("Motion").

13 This Motion is based on this Notice of Motion and Motion, the attached
14 Memorandum of Points and Authorities, the Declaration of Krista L. Freitag, the
15 documents and pleadings already on file in this action, and upon such further oral
16 and documentary evidence as may be presented at the time of the hearing.

17 **Procedural Requirements:** If you oppose this Motion, you are required to
18 file your written opposition with the Office of the Clerk, United States District
19 Court, 312 North Spring Street, Los Angeles, California 90012 and serve the same
20 on the undersigned not later than 21 calendar days prior to the hearing.

21 **IF YOU FAIL TO FILE AND SERVE A WRITTEN OPPOSITION** by the
22 above date, the Court may grant the requested relief without further notice. This
23 Motion is made following the conference of counsel pursuant to L.R. 7.3.

24 Dated: October 14, 2016

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP

By: /s/ Edward Fates
EDWARD G. FATES
Attorneys for Receiver
KRISTA L. FREITAG

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I. EXECUTIVE SUMMARY**

3 The Receiver has now completed the forensic accounting and Phases I and II
4 of the claims process. The Receiver's forensic accounting initially showed investor
5 net losses of approximately \$72.2 million (approximately \$90.8 million received
6 from investors and approximately \$18.6 million distributed to investors). The
7 Receiver performed additional claims-related work on offshore bank account
8 deposits, which resulted in additional investor deposit confirmation of
9 approximately \$8.6 million, for a total of \$80.8 million in investor net losses.

10 The two-phased claims review process has been completed in an effort to
11 reconcile the amount of claims (which totaled an amount far greater than the
12 identified net loss) against the identified net loss. At the end of Phase I of the claims
13 process, claims representing 72,253 separate investments ("claimed investments")
14 had been submitted. Such claims totaled approximately \$412 million¹ in claimed
15 investments.

16 In sharp contrast to the identified net loss of \$80.8 million transacted in the
17 defendant entity bank accounts, investor claims totaled approximately \$412 million
18 and Defendants estimated to the Commission that \$890 million worth of points had
19 traded on the "secondary market" in this scheme. Furthermore, countless claims
20 included manually prepared documentation explaining claimants' non-defendant
21 entity payee trail, with no bank records for the funds "invested." Thus, with the vast
22 majority of funds never reaching company bank accounts, the goal of the Receiver's
23 work in Phase II of the claims process was to identify as many supported and
24

25 ¹ The previously reported \$386 million number for claims submitted did not yet
26 include any currency conversion impact; the \$412 million number represents the
27 final amount after the currency conversion on the proposed allowed claim
28 amounts – proposed disallowed claims were not converted. Furthermore, there
were 500 claims initially categorized by claimants as 'other' – upon review, these
claims were determined to be investor claims and have been added to the final
count, such that the final investor claims count was 72,753.

1 allowable claims as reasonably possible. The total claims for which claimants
 2 ultimately provided bank record support total \$39,900,905; the Receiver's
 3 supplemental automated query testing, a final effort to bring in more allowed claims,
 4 resulted in additional allowed claims recommendation of \$10,707,324, which
 5 positively impacted 1,607 investors.

6 The following tables summarize the total allowed and disallowed claims
 7 pursuant to the Receiver's recommendations, which claims are calculated based on
 8 each claimant's direct net loss:

<u>INVESTOR CLAIMS:</u>	Number of Claimed Investments	% of Total Claimed Investments	Total Dollar Value of Claimed Investments	% of Total Claimed Investments
Allowed	4,018	5.6%	\$25,277,129	6.1%
Partially Allowed	7,159	9.8%	\$25,331,100	6.2%
Total Allowed	11,177	15.4%	\$50,608,229	12.3%
Disallowed (includes Disallowed portion of Partially Allowed)	61,576	84.6%	\$361,751,473	87.7%
Total Claimed Investments	72,753	100.0%	\$412,359,702	100.0%

<u>TRADE CREDITORS AND PERSONNEL CLAIMS:</u>	Number of Claimed Investments	% of Total Claimed Investments	Total Dollar Value of Claimed Investments	% of Total Claimed Investments
Allowed	16	69.6%	\$37,680	5.1%
Partially Allowed	4	17.4%	\$74,806	10.1%
Sub-Total Allowed	20	87.0%	\$112,486	15.2%
Disallowed (amount includes Disallowed portion of Partially Allowed claims)	3	13.0%	\$621,950	84.8%
Total	23	100.0%	\$734,436	100.0%

26 The claims review process has been extremely challenging and many claims
 27 have been disallowed due to the limited available data on investor transactions with
 28 the Receivership Entities, the very large volume of cash claims, and the very large

1 amount of investors who gave their money, including cash, to leaders or other
2 individuals (some of whom perpetrated their own side scheme) and did not/could
3 not provide bank record documentation to support their claim. Given the disconnect
4 between the claims amount and the funds transacted at the defendant entity level, in
5 order to maintain the integrity of the claims process, the Receiver has limited claims
6 which she recommends be allowed to those that have been verified through the
7 testing procedures² described herein. Section III below provides a summary of the
8 detailed claims review and testing work performed by the Receiver and her Court-
9 approved claims administrator, Epiq Systems ("Epiq"), including the proposed
10 Allowed, Partially Allowed, and Disallowed claims.

11 The Receiver's omnibus (investors) and specific (trade/personnel) objections
12 are discussed in Sections IV and V below, including her recommendation that
13 claims be calculated based on each claimant's direct net loss and limited to such
14 amount.

15 Finally, Section VI discusses the Receiver's proposed Distribution Plan and
16 interim distributions to investors and creditors pursuant thereto, including her
17 recommendation that all holders of allowed claims receive a *pro rata* distribution of
18 available receivership estate assets and that \$21 million be initially distributed upon
19 approval of this Motion.

20 II. BACKGROUND FACTS

21 On June 3, 2015, the Receiver filed her Motion for Order: (1) Setting Claims
22 Bar Date; (2) Approving Claim Forms; and (3) Approving Engagement of Third
23 Party Claims Administrator ("Motion"). Dkt. No. 341. The Court granted the
24 Motion on July 13, 2015, and set November 9, 2015, as the deadline to submit
25 claims ("Claims Bar Date"). Dkt. No. 354.

26

27 ² Such procedures were expanded to include supplemental testing in light of the
28 fact that a limited number of claimants initially provided bank records to support
their claims.

1 On October 23, 2015, due to the low initial response rate from investors, the
2 Receiver filed an *Ex Parte* Application to Extend the Claims Bar Date to
3 December 24, 2015 ("*Ex Parte* Application"). Dkt. No. 396. On December 24,
4 2015, at 11:59 p.m., the Court-approved extended time period for investors to
5 submit claims officially ended.

6 On March 11, 2016, the Receiver filed her report regarding Phase I of the
7 claims process and *ex parte* application for approval of recommendation for Phase II
8 ("Phase II Recommendation"). Dkt. No. 427. The Court approved the Phase II
9 Recommendation on March 11, 2016. Dkt. No. 430.

10 On July 22, 2016, with about 95% of the claims review work completed, the
11 Receiver sought an extension of the July 31, 2016 deadline to file her motion to
12 allow and disallow claims. Dkt. No. 455. The reason was because at that time, only
13 2,785 (approximately 4% of claims totaling \$22.7 million) had been properly
14 supported by bank records and matched to a deposit in the defendant entity bank
15 deposit records. Therefore, the Receiver requested a 75-day extension to
16 October 14, 2016 to run supplemental checks designed to identify more investors
17 with net losses and allow their claims even if they didn't provide sufficient bank
18 record support. The Court approved the requested extension on July 25, 2016. Dkt.
19 No. 458.

20 The Receiver's detailed forensic accounting, performed pursuant to the
21 Court's orders, provides additional foundation and support for the Receiver's review
22 and analysis of claims. The Receiver's forensic accounting report detailing the
23 sources and uses of Receivership Entity funds and assets was filed on February 27,
24 2015. Dkt. No. 302.

25 **III. REPORT ON FINAL RESULTS OF THE CLAIMS PROCESS**

26 In order to summarize the Phase I results, the claims data was preliminarily
27 categorized into four pots based on running each claimed investment through an
28 automated algorithm to identify and match claimant names with the two primary

1 databases used to review claims – the SQL Database recovered by the Receiver and
2 the Actual Deposit File created by the Receiver to record all cash, check, and wire
3 deposits made directly into defendant entity bank accounts. The claimed
4 investments were initially placed into four pots as follows:

- 5 1. Pot #1 - The claimant's name was matched to both the SQL Database
6 AND the Actual Deposit File.
- 7 2. Pot #2 - The claimant's name was matched to the SQL Database
8 BUT NOT the Actual Deposit File.
- 9 3. Pot #3 - The claimant's name was matched to the Actual Deposit File
10 BUT NOT the SQL Database.
- 11 4. Pot #4 - The claimant's name was NOT matched to either the SQL
12 Database or the Actual Deposit File.

13 The Receiver has now completed Phase II of the claims review process,
14 including reviewing all investor claimed investments and responses to claim
15 deficiency notices and performing supplemental checks designed to match investor
16 claims by developing queries with various criteria between the Actual Deposit File,
17 the claims database, and the SQL Database. Declaration of Krista Freitag filed
18 herewith ("Freitag Decl."), ¶ 2. The steps taken during the Receiver's review of the
19 72,753 claimed investments are as follows.

20 **A. Initial Testing**

21 Throughout Phase I of the claims process, the Receiver strongly encouraged
22 claimants to submit bank records supporting their claims. Yet a significant number
23 of claimants submitted a copy of their identification only, no documentation, or
24 insufficient documentation. Thus, for all claimed investments, the initial round of
25 manual review resulted in the following categories:

26
27
28

- 1 1. Sufficient bank record support:³
- 2 a. Records support payment directly to a Receivership Entity.
- 3 b. Records support payment to a "leader" or other individual (an
- 4 investor who recruited and often aggregated funds from other
- 5 investors).
- 6 2. No or insufficient bank record support (*e.g.*, bank records provided
- 7 do not directly support the claim or no bank records were provided
- 8 (but rather handwritten notes and other paperwork was)).
- 9 3. Disallowed – claims that duplicate other claims.

10 Freitag Decl., ¶ 5.

11 For the claimed investments with bank records supporting payment directly to
12 a Receivership Entity bank account, such support was tested against the Actual
13 Deposit File. If a match was made, the claimed investment was conditionally
14 allowed. A conditionally allowed claim means that prior to an "Allowed"
15 designation being assigned further testing against the disbursements included on
16 claims was performed to capture the net loss. Freitag Decl., ¶ 6.

17 For conditionally allowed claims at this point, it is important to note that only
18 the actual amount invested, as supported by bank records and which tied to the
19 Actual Deposit File was deemed conditionally allowed. There are instances where
20 the claimed investment amounts were higher than what was conditionally allowed
21 because only part of the claimed investment could be verified (*e.g.*, if the claimants
22 included both the dollars they invested and the value of their fictitious WCM777
23 "points" in their claims). These claims were placed in the "Partially Allowed"
24 category. Freitag Decl., ¶ 7.

25

26 ³ An example of sufficient bank record support is a copy of a canceled check
27 payable to a defendant entity or a leader; whereas insufficient bank record
28 support examples include a copy of a check paid to 'cash,' a cash withdrawal slip
with no indication of where the funds went, or a copy of a deposit slip into a non-
defendant entity bank account with no indication of the recipient name.

1 If sufficient bank record support for a transfer made to a "leader" or other
2 individual was provided, such investment was conditionally allowed as a "paid
3 leader" claim, pending secondary testing discussed further below. Freitag Decl., ¶ 8.

4 The claimed investments which fell into the second and third categories above
5 (insufficient bank record support and disallowed/duplicate) were initially
6 determined to be deficient. Such investment claimants, along with any Partially
7 Allowed claimants, were sent deficiency notices⁴ to give each claimant an additional
8 opportunity to provide proper bank records supporting their claims. Claimants were
9 given 20 days to respond to such deficiency notice, responses to which were then
10 manually reviewed. In total, 30,389 deficiency notices representing 69,539 claimed
11 investments were sent; only 3,779 deficiency responses were received and reviewed.
12 Freitag Decl., ¶ 9.

13 **B. Secondary Testing on Deficiency Notices**

14 For claimed investments that were initially classified as deficient (as
15 discussed above), deficiency notices were issued and the responses were manually
16 reviewed. If a claimant's response included bank record documentation supporting
17 the claim, such claimed investment was re-categorized from deficient to
18 conditionally allowed (whether it was a direct payment to a defendant entity or a
19 payment to a leader and as such categorized as a "paid leader" claim). If no or
20 insufficient documentation was included in a response, the investment remained in
21 the deficient category pending supplemental testing discussed further below.
22 Freitag Decl., ¶ 10.

23
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27 ⁴ Deficiency Notices were translated in six (6) languages. Initial round and
28 deficiency response documentation was translated as necessary, primarily
Mandarin, Spanish, and Russian.

1 **C. Secondary Testing on Conditionally Allowed Claimed Investments**
2 **Paid to Leaders**

3 For conditionally allowed "paid leader" claimed investments (where the
4 claimant provided bank record support confirming payment to another individual
5 rather than a defendant entity), secondary testing against the Actual Deposit File
6 was completed to confirm that leader deposited funds into a defendant entity
7 account. If the Actual Deposit File reflects (previously unassigned) deposits from
8 such leader, the claimed investment remained conditionally allowed.

9 For "paid leader" claimed investments where the Actual Deposit File does not
10 reflect payments from the applicable leader, an additional level of testing was
11 performed whereby each claimed investment was tested against the SQL Database
12 to match the claimant name. If the claimant, who has provided bank record support
13 confirming payment to a leader, was reflected in the SQL Database, the claimed
14 investment remained conditionally allowed.

15 **D. Supplemental Testing**

16 With the testing work described above about 95% completed, the number of
17 claimed investments with sufficient bank record support that had been matched to
18 deposits into Receivership Entity accounts was very small – only 2,785 or
19 approximately 4% of claimed investments. The total amount of these claimed
20 investments is \$22.7 million. As noted above, the Receiver's forensic accounting
21 had shown that investor net losses were approximately \$72.2 million, leaving
22 approximately \$49.5 million in net losses which had not been matched to any
23 claims. Accordingly, the Receiver requested additional time to perform certain
24 supplemental checks to try and match more claimed investments to actual deposits
25 into Receivership Entity bank accounts such that the largest number of investors
26 possible could participate in the distribution of receivership estate funds. Dkt.
27 No. 455. As noted above, the Court approved the request. Dkt. No. 458.

28

1 The supplemental testing was performed on all claimed investments that were
2 (a) not already conditionally allowed, or (b) not already disallowed outright as
3 duplicate and resulted in additionally recommended allowed claims in the amount of
4 \$10,707,324, positively impacting 1,607 investors. The supplemental testing was
5 run from the Actual Deposit File (all deposits not previously assigned to a
6 conditionally allowed claim) and included the following:

- 7 • Testing all unassigned *non-cash deposits* to the claimed investments by
8 claimant name. If the supplemental testing resulted in a positive match,
9 the lesser of the claimed investment or deposit amount was conditionally
10 allowed.
- 11 • Testing all remaining deficient claimed investments with payments to a
12 leader against the unassigned *non-cash deposits* in the Actual Deposit File
13 to determine if there are any deposits from such leader. The positive
14 matches were further tested against the SQL Database by claimant name.
15 The goal of this testing category was to capture investors who paid leaders
16 in cash, but did not provide bank record support. Therefore, the
17 parameters for claimed investments in this category were set at a
18 maximum of \$25,000 (virtually all single cash deposits made into the
19 Receivership Entity bank accounts were less than \$25,000).⁵
 - 20 ○ If the Actual Deposit File reflects (previously unassigned) payments
21 from such leader and the claimant name was in the SQL Database,
22 the claimed investment was conditionally allowed, such that the
23 claimant's recommended Allowed claim for this category does not
24 exceed \$25,000.

25
26
27 ⁵ The claim form asked claimants to specify whether their claimed investments
28 were made by cash, check, or wire. However, many claimants checked the
wrong box or did not check a box, so the cash/non-cash information in the claims
database could not be relied upon to isolate cash claimed investments.

- Testing all unassigned *cash* deposits to the claimed investments *by date and amount*. For the date and amount matches, the match was then tested against the claimant name in the SQL Database. If these criteria were met, but amount did not exactly match the SQL Database, the lesser of the two amounts was conditionally allowed.

Freitag Decl., ¶ 11.

E. Final Testing

One final test was run on all conditionally allowed claimed investments to capture the claimants' net loss amounts. In so doing, each conditionally allowed claim was reduced by the disbursements included on the claimant's claim. Freitag Decl., ¶ 12.

F. Final Results of Claims Testing

With all of the claims testing and supplemental testing work now completed, the investor claims results are as follows:

	Total Number of Claimed Investments		Total Dollar Value of Claimed Investments	
Total Claimed Investments	72,753		412,359,702	
	Number of Claimed Investments	% of Total Claimed Investments	Total Dollar Value of Claimed Investments	% of Total Claimed Investments
Allowed	4,018	5.6%	\$25,277,129	6.1%
Partially Allowed	7,159	9.8%	\$25,331,100	6.2%
Total Allowed	11,177	15.4%	\$50,608,229	12.3%
Disallowed (includes Disallowed portion of Partially Allowed)	61,576	84.6%	\$361,751,473	87.7%
Total Claimed Investments	72,753	100.0%	\$412,359,702	100.0%

1 Freitag Decl., ¶ 13. There were 23 trade and personnel-related claims submitted in
 2 the total amount of \$734,436. The results of the review and testing of these claims
 3 are as follows and are further discussed below in Section V:

	#	Amounts
<u>TRADE CREDITOR CLAIMS:</u>		
Allowed ⁶	6	\$3,995
Partially Allowed	2	\$61,806
Sub-Total Trade Claims Allowed	8	\$65,801
<u>PERSONNEL CLAIMS:</u>		
Allowed	10	\$33,685
Partially Allowed	2	\$13,000
Sub-Total Personnel Claims Allowed	12	\$46,685
Total Trade Creditor and Personnel Claims Allowed	20	\$112,486
Total Trade Creditor and Personnel Claims Disallowed	3	\$621,950
Grand Total Trade Creditor and Personnel Claims	23	\$734,436

13 Freitag Decl., ¶ 14.

14 **IV. OMNIBUS OBJECTIONS TO INVESTOR CLAIMS**

15 Pursuant to the claims testing work described above, the Receiver has created
 16 three lists of claims with their recommended treatment, each of which is attached to
 17 the Freitag Declaration – Allowed Claims (Exhibit A), Partially Allowed Claims
 18 (Exhibit B), and Disallowed Claims (Exhibit C). Allowed Claims are claims that
 19 have been tested and verified, and the Receiver recommends that they be allowed in
 20 their full amount. Partially Allowed Claims are claims that have been tested and
 21 partially verified, and the Receiver recommends they be allowed at the
 22 reduced/verified amount specified on Exhibit B. Disallowed Claims are claims that
 23 have been reviewed and tested, but could not be verified or are outright denied due
 24 to a duplicate claim being filed. The Receiver recommends these claims be
 25 disallowed. Freitag Decl., ¶ 15.

26
 27 ⁶ This number includes a \$1,699.01 Employment Development Department claim
 28 filed directly with this Court on September 11, 2014, for fourth quarter 2013
 (pre-receivership) taxes (Dkt. No. 195).

1 Generally speaking, there are many different reasons claims have been placed
2 in the Disallowed or Partially Allowed categories:

- 3 • More than \$412 million of investor claims were received and the net
4 loss transacted at the defendant entity level was \$80.8 million, so the
5 number of disallowed claims is necessarily large.
- 6 • This scheme involved countless ways in which investors purportedly
7 transferred funds, much of which went to leaders or other individuals
8 and may or may not have ever reached the Receivership Entities.
- 9 • Approximately 82% of the claimed investments (including a large
10 number of "paid leader" claims) were submitted as cash (58,481
11 claimed investments or \$270 million), which is inherently difficult to
12 verify.⁷
- 13 • The vast majority of claimants either submitted no documentation
14 (other than ID) or handwritten/non-bank record documentation, which
15 is very difficult to verify.

16 Freitag Decl., ¶ 16.

17 The most common reason claimed investments were disallowed is because
18 the claimant did not provide any bank record support that would allow the Receiver
19 to verify the claimed investment and such claimed investment could not be verified
20 through the supplemental testing efforts described above. Freitag Decl., ¶ 17.

21 With respect to claimants who failed to provide sufficient documentation, it
22 should be noted that all claimants were specifically instructed on numerous
23 occasions to submit all documentation supporting their claims, with banking records
24 strongly recommended. This instruction was given in the notices/instructions sent to
25 investors, on the electronic claims portal, on the receivership website, when
26 investors called or sent emails with questions, and in the deficiency notices emailed

27 _____
28 ⁷ Nonetheless, there were claimants who did validate their cash deposits into the
defendant entities.

1 to claimants whose claims could not be verified. In addition, in order to make it
2 easier for claimants to submit documents, the Receiver accepted hard copy
3 documents by mail rather than requiring all documents to be submitted
4 electronically. Furthermore, even if claimants did not initially submit bank records
5 or sufficient support, the Receiver did send deficiency notices to all and gave them a
6 second opportunity to submit sufficient bank records to support their claims – only a
7 small fraction of claimants responded to such notices. Lastly, because the vast
8 majority of claimants did not provide sufficient bank records to support their claim,
9 supplemental tests were run in an attempt to conditionally approve more claimed
10 investments. Freitag Decl., ¶ 18.

11 The Receiver, with assistance from Epiq, has spent substantial time and effort
12 reviewing, testing, and verifying claims. Her goals throughout the process have
13 been to (a) identify as many actual investors as possible, (b) ascertain the proper
14 amounts of their claims, and (c) treat all claimants fairly and equitably.
15 Accordingly, the Receiver asks that the proposed allowed amounts of claims and
16 disallowance of claims reflected on Exhibits A, B, and C attached to the Freitag
17 Declaration be approved. Freitag Decl., ¶ 19.

18 V. SPECIFIC OBJECTIONS TO CLAIMS

19 Certain claims submitted to the Receiver are not for investment losses, but
20 other losses or damages claimed by third parties – notably vendors (trade creditors)
21 and personnel of the defendant entities. There were 11 trade creditor claims (one of
22 which was filed directly with the Court) and 12 personnel claims submitted. From
23 an amount perspective, as further discussed hereinafter, the vast majority of this
24 claimant "pool" was Disallowed.

25 **Personnel** – the Receiver reviewed each personnel claim to (a) ensure that
26 they were previously employed (directly or via contract) by one of the Receivership
27 Entities, (b) cross reference to their compensation records, and (c) prorate the
28

1 compensation for the known unpaid 26 day-period that each person worked prior to
2 the Receiver's appointment.

3 **Trade Creditors** – for the most part, with the exception of those discussed
4 below, the Receiver recommends that vendors who provided goods or services to
5 the Receivership Entities prior to the Receiver's appointment and submitted a claim
6 be allowed.

- 7 • One vendor submitted a \$146,054.03 claim for labor and supplies
8 related to oil exploration services provided to Aeon Operating, Inc., but
9 it was determined that none of the Receivership Entities is liable to the
10 vendor. The vendor was given the opportunity (via a phone call and
11 email request) to provide additional information to substantiate that a
12 Receivership Entity was liable for the claim. However, the vendor
13 failed to respond. Accordingly, the Receiver proposes the claim be
14 disallowed.
- 15 • PNC, the vendor that provided financing for the golf carts at the Links
16 at Summerly and Glen Ivy Golf Club filed two claims, one claim for
17 each of those leases. After discussions with PNC, the claim for Glen
18 Ivy was withdrawn because that lease was assumed by the Glen Ivy
19 buyer. However, when the Links at Summerly was sold, the buyer did
20 not assume the golf cart lease. The Receiver, therefore, terminated the
21 lease. After various discussions with PNC, the Receiver was able to
22 reconcile the amount due under the contract, which reduced the
23 Summerly claim by nearly \$20,000. The various discussions with
24 PNC, including the withdrawn claim and the reconciliation with the
25 contract, reduced the claim by a total of \$287,658.10, resulting in an
26 agreed-upon \$61,079.41 non-priority claim.
- 27 • Michael Norton submitted a claim in the amount of \$200,000. The
28 documents submitted with the claim, however, do not support the

1 claimed amount. Mr. Norton appears to have entered into a joint
2 venture agreement with Defendants Ming Xu and WCM. It appears
3 Mr. Norton then incurred a modest amount of business expenses in
4 furtherance of the agreement. The joint venture never materialized, so
5 Mr. Norton's losses were limited to the business expenses he incurred.
6 The receipts provided by Mr. Norton show that he incurred \$726.46 in
7 business expenses. The remainder of the claim is not supported by any
8 documentation indicating Mr. Norton suffered actual losses.
9 Accordingly, the Receiver proposes Mr. Norton's claim be partially
10 allowed in the amount of \$726.46.

11 These creditor claims, and the Receiver's proposed allowed amount for each
12 of them, are listed on Exhibit D to the Freitag Declaration. Freitag Decl., ¶ 20.

13 **VI. DISTRIBUTION PLAN AND INTERIM DISTRIBUTIONS**

14 Once the allowed amount of each claim is set, the Receiver will be in a
15 position to distribute the bulk of the funds in the receivership estate. Accordingly,
16 the Receiver seeks approval of a plan of distributing receivership estate funds to the
17 holders of allowed claims. The Receiver's proposed plan, which is attached to the
18 Freitag Declaration as Exhibit E ("Distribution Plan"), includes the following
19 features:

- 20 • All administrative claims, including Court-approved fees and costs of
21 the Receiver and her professionals, will be paid in full upon entry of
22 orders allowing such fees and costs and authorizing payment;
- 23 • All holders of allowed claims, including investors, trade creditors, and
24 employees will receive a *pro rata* share of funds distributed based on
25 the allowed amount of their claims;
- 26 • Distributions will be made in the form of checks or PayPal – whichever
27 method each claimant selected when they submitted their claim;

- 1 • Once the initial distribution amount is approved by the Court and
2 interim distribution payments are issued, the Receiver may make
3 further interim distributions pursuant to the Plan in her discretion and
4 with notice to the Court and the Commission's review and approval,
5 with the goal of returning funds to investors as promptly and efficiently
6 as possible; and
- 7 • The Court shall retain jurisdiction to resolve any and all disputes
8 relating to claims against the receivership estate, the Plan or
9 implementation thereof, or the Receiver's performance of her duties.

10 Freitag Decl., ¶ 21.

11 **A. Initial Interim Distribution Amount**

12 The Receiver is currently holding approximately \$27 million in cash.
13 Although the majority of the work to administer and liquidate the assets of the
14 receivership estate has been completed, the Receiver continues her work to liquidate
15 certain smaller assets and enforce judgments and settlements. Considering the work
16 that remains to be done, and so that the estate has a sufficient contingency reserve,
17 the Receiver proposes to distribute \$21 million upon entry of an order approving
18 this Motion. As noted above, the Receiver will distribute additional amounts with
19 notice to the Court and approval from the Commission as her administration of the
20 receivership estate progresses. The Receiver will then seek permission to make a
21 final distribution in connection with her final accounting and motion to conclude the
22 receivership. Freitag Decl., ¶ 21.

23 **VII. ARGUMENT**

24 "The power of a district court to impose a receivership or grant other forms of
25 ancillary relief does not in the first instance depend on a statutory grant of power
26 from the securities laws. Rather, the authority derives from the inherent power of a
27 court of equity to fashion effective relief." *SEC v. Wencke*, 622 F.2d 1363, 1369
28 (9th Cir. 1980). The "primary purpose of equity receiverships is to promote orderly

1 and efficient administration of the estate by the district court for the benefit of
2 creditors." *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir 1986). As the appointment
3 of a receiver is authorized by the broad equitable powers of the court, any
4 distribution of assets must also be done equitably and fairly. See *SEC v. Elliot*,
5 953 F.2d 1560, 1569 (11th Cir. 1992).

6 District courts have the broad power of a court of equity to determine the
7 appropriate action in the administration and supervision of an equity receivership.
8 See *SEC v. Capital Consultants, LLC*, 397 F.3d 733, 738 (9th Cir. 2005). The Ninth
9 Circuit explained:

10 A district court's power to supervise an equity receivership
11 and to determine the appropriate action to be taken in the
12 administration of the receivership is extremely broad. The
13 district court has broad powers and wide discretion to
14 determine the appropriate relief in an equity receivership.
15 The basis for this broad deference to the district court's
supervisory role in equity receiverships arises out of the
fact that most receiverships involve multiple parties and
complex transactions. A district court's decision
concerning the supervision of an equitable receivership is
reviewed for abuse of discretion.

16 *Id.* (citations omitted); see also *CFTC v. Topworth Int'l, Ltd.*, 205 F.3d 1107, 1115
17 (9th Cir. 1999) ("This court affords 'broad deference' to the court's supervisory role,
18 and 'we generally uphold reasonable procedures instituted by the district court that
19 serve th[e] purpose' of orderly and efficient administration of the receivership for
20 the benefit of creditors.").

21 **A. Legal Standards and Procedures for Determining Claims**

22 In overseeing a receivership, the court must "make rules which are practicable
23 as well as equitable." *Hardy* at 1039, quoting *First Empire Bank-New York v.*
24 *FDIC*, 572 F.2d 1361, 1368 (9th Cir. 1978). The Receiver requests the Court set the
25 following rules and procedures in the interests of fairly and efficiently administering
26 claims against the receivership estate:

27 First, all claims should be resolved via summary proceedings. District Courts
28 have the power to use "summary procedures in allowing, disallowing, and

1 subordinating claims of creditors . . ." *United States v. Arizona Fuels Corp.*,
2 739 F.2d 455, 458 (9th Cir. 1984). Plenary proceedings to resolve a claim would
3 unduly delay the administration of the case and consume receivership estate
4 resources.

5 Second, all claims should be calculated using a simple, money-in/money-out
6 formula that limits claims to each investor's net loss from the Receivership Entities.
7 The money-in/money-out or "MIMO" formula has been endorsed by the Ninth
8 Circuit Court of Appeals and other courts in fraud cases where, like here, the assets
9 of the estate are insufficient to satisfy all claims in full. *See Capital Consultants*,
10 397 F.3d at 738 (describing a net claim calculation as "an administratively workable
11 and equitable method of allocating the limited assets of the receivership");
12 *Topworth*, 205 F.3d at 1116; *In re Tedlock Cattle Company Inc.*, 552 F.2d 1351,
13 1354 (9th Cir. 1977); *In re Taubman*, 160 B.R. 964, 980-82 (Bankr. S.D. Ohio
14 1993). Thus, only the amounts invested by and distributed to investors in the
15 Receivership Entities should be used to determine allowed claim amounts and that
16 all additional amounts claimed should be disallowed. Similarly, the Receiver
17 proposes claims for accrued or unpaid interest, late fees, attorney fees, consequential
18 damages or lost profits arising from non-payment, and punitive or tort damages be
19 disallowed.

20 Third, as in a bankruptcy case, it should be a claimant's burden to establish a
21 valid claim against the receivership estate. *See Lundell v. Anchor Constr.*
22 *Specialists, Inc.*, 223 F.3d 1035, 1039 (9th Cir. 2000); *Revere Copper &*
23 *Brass, Inc. v. Adriance Machine Works, Inc.*, 76 F.2d 876, 878 (2d Cir. 1935)
24 (claimants failed to sustain burden of proving claims against receivership). Here,
25 investors who failed to provide sufficient bank record support and whose claims
26 could not be identified via Receivership Entity bank records were sent a deficiency
27 notice and instructed to provide all documents supporting their claims.
28 Accordingly, claims submitted without sufficient bank record support or which the

1 Receiver has been unable to match (via automated query) to a deposit into a
2 Receivership Entity bank accounts and the SQL Database should be disallowed.

3 These rules will promote an orderly, fair, and efficient administration of
4 claims. Indeed, considering the (a) high number of claimed investments (72,753),
5 (b) very large amounts investors claimed (\$412 million), (c) number of claims
6 submitted without sufficient bank record support, (d) number of individual or leader
7 payment claims submitted with several degrees of separation (*e.g.*, investor "a" paid
8 investor "b" on behalf of investor "c," so on and so forth), funds associated with
9 which are nearly impossible to trace to the defendant entities, and (e) high number
10 of suspicious claims (notably, approximately 27,000 claims were submitted
11 immediately before the December 24, 2015 deadline), the proposed rules and
12 procedures for determining claims are absolutely critical. Without them, it would
13 not be possible to determine claims in a consistent, fair, and efficient manner and to
14 distribute receivership estate funds to those with allowed claims.

15 **B. Proposed Allowed Claim Amounts**

16 The Receiver's omnibus (investors) and specific (trade/personnel) objections
17 to claims are detailed in Sections IV and V above. Based on those omnibus and
18 specific objections, the Receiver asks the Court to approve the proposed allowed
19 amounts of claims listed on Exhibits A, B, C, and D to the Freitag Declaration. The
20 Receiver has conducted the review and analysis of claims described in Sections II
21 and III above and applied the legal standards discussed in Section VII.A above in
22 arriving at the proposed allowed amount of each claim.

23 The Receiver proposes investor claims where the claimed investments could
24 not be matched to any deposits into Receivership Entity bank accounts and the SQL
25 Database, either directly or through another investor, be disallowed. Although it is
26 possible that claims of some investors who gave cash to another investor and
27 therefore are unable to substantiate their claims will be disallowed, there is no
28 reliable and consistent way to differentiate such investors from people who

1 transferred funds to a leader operating a side scheme or people asserting bogus or
2 duplicative claims. The huge volume of cash transactions, including those amongst
3 individuals, and the lack of investor bank record support means the claims review
4 and analysis cannot be perfect. The scheme itself was wildly disorganized, with
5 numerous individuals paying cash to other (and oftentimes unknown) individuals⁸
6 and leaders propagating their own scheme of sorts (selling points for their own
7 profit such that "investors" paid money to individuals who never forwarded said
8 funds to the defendant entities), making the claims review process extremely
9 challenging. That said substantial effort has been made to make the system as fair
10 and inclusive as possible. The Receiver has not only attempted to match each
11 sufficiently supported claim to a deposit, but has also conducted supplemental
12 testing to try and match unclaimed deposits to unsupported and unidentified claims.
13 This was successful in many instances and reduced the number of real investors
14 whose claims may be disallowed.

15 **C. Distribution Plan**

16 The primary objective in establishing a plan for distributing assets in a federal
17 equity receivership should be to treat all claimants fair and equitably. The key
18 feature of the proposed Distribution Plan is that all holders of Allowed or Partially
19 Allowed claims, including investors and creditors, will receive *pro rata* distributions
20 from available assets of the receivership estate based on the allowed amounts of
21 their claims. This is the most fair and equitable method of distributing assets of the
22 receivership estate under the circumstances. The Receivership Entities were
23 operated as one fraudulent enterprise, with different entities used at different times,
24 and funds extensively commingled and transferred between and among them. There
25 is no basis on which to draw distinctions between Receivership Entities and treat
26 investors or creditors differently because they happened to deposit funds or transact

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28 ⁸ For example, in the Commission's Complaint, Defendants had estimated that \$890 million worth of the points had traded on the "secondary" market.

1 business with one entity instead of another. Indeed, to do so would be to create
2 artificial lines and prefer some investors and creditors over others, which would run
3 contrary to the goal of treating all holders of allowed claims as fairly and equitably
4 as possible.

5 The Distribution Plan also provides that the Receiver can make future interim
6 distributions to holders of allowed claims, pursuant to the terms of the Distribution
7 Plan, in her business judgment, with prior notice to the Court and with the approval
8 of the Commission. This provision is simply designed to minimize administrative
9 expenses associating with making multiple motions to the Court. The Receiver will
10 file a final accounting and seek permission to make a final distribution to holders of
11 allowed claims at the conclusion of the receivership.

12 **D. Interim Distributions**

13 The Receiver is currently holding approximately \$27 million in cash.
14 Although some asset sale and judgment collection efforts are ongoing, the vast
15 majority of receivership estate assets have been liquidated. Once the Court has
16 ruled on this Motion, the allowed amount of all claims will be set, a distribution plan
17 will be established, and the Receiver will be in a position to distribute the majority
18 of the funds in the receivership estate to the holders of allowed claims. Considering
19 the work remaining to be done, and so that the estate has a sufficient contingency
20 reserve, the Receiver proposes to distribute \$21 million upon entry of an order
21 approving this Motion.

22 With respect to distribution checks that are not deposited within 90 days or
23 PayPal payments that are unsuccessful because the applicable claimants changed
24 their physical or email address or PayPal account address without informing the
25 Receiver, the Receiver will use reasonable efforts to locate alternate contact
26 information for the claimants (email addresses or telephone numbers) and attempt to
27 contact them and reissue the check or PayPal payment. If those efforts are
28 unsuccessful within 180 days of the check or payment being first issued, the claim

1 will be extinguished and the funds returned to the receivership estate for distribution
2 at a future date.

3 As the receivership progresses and it becomes possible to safely distribute
4 additional funds from the estate, as discussed above, the Receiver will notice the
5 Court and seek approval from the Commission to distribute additional interim
6 amounts. All distributions will be made pursuant to the terms of the Distribution
7 Plan (assuming it is approved by the Court).

8 **VIII. CONCLUSION**

9 Based on the foregoing, the Receiver requests an order sustaining her
10 omnibus (investors) and specific (trade/personnel) objections to claims discussed
11 above, approving the proposed allowed amounts of investor and creditor claims as
12 reflected on Exhibits A through D to the Freitag Declaration, approving the
13 Distribution Plan attached as Exhibit E to the Freitag Declaration, and authorizing
14 the Receiver to make interim distributions to the holders of allowed claims in the
15 total amount of \$21 million.

16 Dated: October 14, 2016

ALLEN MATKINS LECK GAMBLE
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18 By: /s/ Edward Fates

19 EDWARD G. FATES
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