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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SOUTHERN DIVISION

Consumer Financial Protection Bureau and Maria T. Vullo, Superintendent of Financial Services of the State of New York, Plaintiffs, v. Pension Funding, LLC; Pension Income, LLC; Steven Covey; Edwin Lichtig; and Rex Hofelter, Defendants.	Case No. 8:15-cv-1329 **NOTICE OF MOTION AND MOTION FOR:** **(A) APPROVAL OF PROPOSED ALLOWED CLAIM AMOUNTS;** **(B) APPROVAL OF DISTRIBUTION PLAN; AND** **(C) AUTHORITY TO MAKE INTERIM DISTRIBUTIONS;** **MEMORANDUM OF POINTS AND AUTHORITIES** Date: June 2, 2017 Time: 2:30 p.m. Ctrm.: 10A Judge: Hon. Josephine L. Staton

PLEASE TAKE NOTICE that on June 2, 2017, at 2:30 p.m. in Courtroom 10A of the above-entitled Court, located at 411 West Fourth Street, Santa Ana, California 92701-4516, Krista L. Freitag ("Receiver"), the Court-appointed receiver for Pension Funding, LLC, Pension Income, LLC, and their subsidiaries, affiliates, and successors-in-interest, including PGR, LLC (collectively, "Receivership Entities"), will and hereby does move the Court for (a) approval of proposed allowed claim amounts, (b) approval of distribution plan, and (c) authority to make interim distributions ("Motion").

The Motion and Distribution Plan are posted on the Receiver's website (www.ethreeadvisors.com/cfpb-case-docs). A hard copy can also be obtained by emailing a request to the Receiver at pf-pi@ethreeadvisors.com.

Procedural Requirements: If you oppose this Motion, you are required to file your written opposition with the Office of the Clerk, United States District Court, 411 West Fourth Street, Santa Ana, California 92701-4516 and serve the same on the undersigned not later than 21 calendar days prior to the hearing.

IF YOU FAIL TO FILE AND SERVE A WRITTEN OPPOSITION by the above date, the Court may grant the requested relief without further notice. This motion is made following a conference of counsel pursuant to Local Rule 7-3.

Dated: April 25, 2017

ALLEN MATKINS LECK GAMBLE MALLORY & NATSIS LLP

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

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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Having conducted a forensic accounting of the Receivership Entities and a thorough review and analysis of claims, the Receiver now asks the Court to approve her proposed allowed and undisputed net loss claim amounts, approve her proposed plan of distributing receivership assets via the rising tide method (further discussed below), and authorize her to make interim and immediate distributions to holders of allowed claims. The relief requested will provide for an orderly, equitable and efficient distribution, will provide funds to most investors on an interim and immediate basis, and will facilitate winding up the receivership in an efficient fashion.

A. <u>Proposed Allowed Claim Amounts</u>

On December 14, 2016, the Court approved, with one modification, the Receiver's proposed procedures for the administration of investor claims, including that investors[1] would be provided with a notice of the Receiver's calculation of their claim (which would be based on their net loss), given time to respond to the notice, and the Receiver would then seek Court approval of the proposed allowed claim amounts ("Claims Procedures Order"). Dkt. No. 125. The modification to the procedures was that investors would have 60 days (instead of 30 days) to dispute the Receiver's calculation of their net loss and provide documentation supporting their own calculation. The Court also specified that the claim notices sent to investors should be written in plain English so investors can understand the claims process. Dkt. No. 125.

Accordingly, in the final week of December 2016, notices detailing investors' net losses from their investments were sent (via United States Postal Service certified return receipt) to each investor. The notices, a blank example of which is

[1] The terms "investors" and "buyers" are used interchangeably herein.

attached as Exhibit A to the Declaration of Krista Freitag filed herewith ("Freitag Decl."), advised investors that they had 60 days from issuance of the notice to dispute the Receiver's calculation of their net loss, which would be used to determine their allowed claim amount in the receivership. Although responses to the notices were received from approximately 20 investors, none of them disputed the Receiver's calculation. Freitag Decl. ¶ 2.

Accordingly, attached to the Freitag Declaration as Exhibit B is a schedule of proposed and undisputed allowed claim amounts representing each unique, third-party investor's collective[2] net loss.[3] Such net loss is the critically important basis for the calculation of the proposed distribution of remaining assets. As approved by the Court in the Claims Procedures Order, the proposed allowed claim amounts are based on the Receiver's forensic accounting of all transactions into and out of the bank accounts used by the Receivership Entities and pensioners, as well as the calculation of each investor's net loss as determined by their total transfers to and total transfers from the Receivership Entities or the associated pensioners. The Receiver asks that the Court approve the proposed and undisputed allowed claim amounts. Freitag Decl. ¶ 3.

B. <u>Distribution Plan</u>

The Receiver also requests approval of her proposed Distribution Plan, which is attached to the Freitag Declaration as Exhibit C. The Distribution Plan provides for priority payment of all allowed administrative expenses, while all other allowed claims be paid from the remaining assets via the rising tide method of calculating *pro rata* distributions. Freitag Decl. ¶ 4. The other key features of the Distribution Plan are as follows:

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[2] Some investors participated in more than one contract; in such event, the net loss amounts reflect the combined amount of all contracts.

[3] Claims are listed alphabetically by last name of the claimant, with the exception of claims held by trusts or other entities.

1. Pooling of Receivership Funds

As detailed in the Receiver's Forensic Accounting Report and Recommendations (Docket No. 116), the Receivership Entities collected the full investor "purchase price," which was then used to fund (a) upfront, lump sum payments to pensioners, (b) commission and/or agency fee payments, (c) receivership entity management fee, life insurance and reserve impound accounts, and (d) receivership entity "profit." Notably, in the Buyer and Reserve Funds Agreement, it states that each buyer's (8 percent and 2.84 percent) contribution to the reserve funds are for the benefit of all buyers, providing combined resources for the buyer group; and that subject to the financial health of the reserve fund, the buyer gets 100 percent payout even if the pensioner redirects or otherwise defaults. As such and in practice, the Receivership Entities pooled and commingled the investor reserve funds, which have no direct tie to any individual investor/buyer. Freitag Decl. ¶ 5.

When pensioners redirected their pension payments or otherwise defaulted, the Receivership Entities paid investors their contractual payments from the reserve funds without regard to the source of the funds in the reserve account. Many pensioners defaulted, filed bankruptcy, or passed away. Therefore, many investors were regularly paid from the commingled/pooled reserve funds. As mentioned in the Receiver's Forensic Accounting Report and Recommendations, assuming the January 2016 reserve account funds used to pay Investors monthly installments (approximately $80,000) persisted, the Receiver estimated the Receivership Entities' cash (the reserve funds) would have been depleted on or before August 2016. Freitag Decl. ¶ 6.

Moreover, the pooled reserve funds were also used to fund new contracts between the Receivership Entities and pensioners, creating pensioner contracts with no third-party investor directly associated with them. Finally, there is no evidence that investors performed an independent investigation of the particular pensioner whose lump sum advance they were funding or that pensioner's creditworthiness. Instead, it appears investors simply relied on the Receivership Entities to match them with and check pensioner creditworthiness, and then invested based on the representations made to them by the Receivership Entities, including the guarantee that their monthly payments would be made (as long as there were sufficient reserve funds to make the payments). Freitag Decl. ¶ 7.

Under these facts and circumstances, combined with the fact that some investors invested early and some later, the most fair and equitable manner of distributing receivership estate assets is to pool the assets and distribute them *pro rata* (via the rising tide method of calculation) to all investors with allowed claims. If, on the other hand, receivership estate funds were to be divided up on a contract-by-contract basis and investors received only what their pensioners happen to payback, some investors would receive very little (*e.g.*, investors whose pensioners defaulted shortly after funding) and other investors would recover the majority of their investment – the full lump sum the associated pensioner received. Moreover, as noted above, a substantial portion of the funds in the receivership estate (including the Lynk Capital loan participation interest, stipulated judgment amounts paid by Defendants Lichtig and Hofelter, and pensioner payments under contracts with the Receivership Entities) are not directly linked to any one investor and therefore must be pooled and distributed on a *pro rata* basis. Freitag Decl. ¶ 8.

Accordingly, distributing receivership estate funds on a contract-by-contract basis would produce largely arbitrary and inequitable results in that some investors would receive substantially more than others. Accordingly, the proposed Distribution Plan provides that all receivership estate assets will be pooled and investors will receive distributions from the pool based on the allowed amount of their claims and the rising tide method, which is discussed next. Freitag Decl. ¶ 9.

2. Rising Tide Method

Also discussed in the Receiver's Forensic Accounting Report and Recommendations is the fact that some investors recovered a substantial portion of their investment prior to the Receiver's appointment, whereas others recovered only a small percentage. Specifically, on a contract basis, early investors had a net loss of approximately 28% (or recovery of 72%) of their investments, whereas late investors had a net loss of approximately 84% (or recovery of 16%) of their investments. Dkt. No. 116, p. 10. Freitag Decl. ¶ 10.

As a result of this wide variation in existing recoveries, the Distribution Plan attempts to equalize investor recoveries regardless of the timing of investments and takes into account pre-receivership distributions. To accomplish this, the Distribution Plan provides that amounts investors received from the Receivership Entities prior to the Receiver's appointment be accounted for when calculating the rising tide method of *pro rata* distributions. This distribution method, known as the "rising tide" method, allows investors who received very little from the Receivership Entities and/or pensioner (or significantly less than other investors) to recover first. As discussed below, this method has been endorsed by courts as a fair and equitable method of distributing receivership assets in fraud cases. Freitag Decl. ¶ 11.

Use of the rising tide method will allow the Receiver to distribute, on an interim and immediate basis, the recommended amount of $2,904,157.72 (discussed in further detail below) to all investors who received less than **53%** (or with net losses of greater than 47%) of their investment prior to the receivership.[4] Investors who have previously received 53% or more of their investment will not participate in the first round of distributions, but may participate in future rounds depending on amounts the Receiver collects in the future, at which time the rising tide threshold

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[4] If the Court were to order a higher or lower amount of the first distribution, the rising tide threshold percentage to which all investors' recovery will be brought would increase or decrease.

will be increased, thus making more investors eligible to receive a distribution. Freitag Decl. ¶ 12.

For example, suppose there are three investors: Investor A invested $100,000 near the end of the scheme and received/recovered only $16,000 or 16%; Investor B invested $100,000 sometime during the middle of the scheme and received/recovered $40,000 or 40%; and Investor C invested $100,000 in the early stages of the scheme and received/recovered $72,000 or 72%. Investor A would receive $37,000 ($37,000 plus $16,000 already received equals $53,000 or **53%**, the target recovery for this interim distribution) in the initial distribution, Investor B would receive $13,000 ($13,000 plus $40,000 already received equals $53,000 or **53%**, the target recovery for this interim distribution), and Investor C (who already received 72%, an amount higher than the 53% target recovery for this interim distribution) would not participate in the initial distribution. Although very unlikely based upon recovery projections, Investor C could potentially participate in future distributions if and when the "rising tide" brings all other investors up to the 72% recovery Investor C already received. The rising tide, therefore, promotes the fair and equitable treatment of investors by evening out pre-receivership and post-receivership recoveries. Freitag Decl. ¶ 13.

Finally, to avoid unnecessary complication and expense in making distributions, the Distribution Plan provides that all claims submitted to the Receiver after March 1, 2017 (of which there are currently none) are automatically disallowed. The Receiver sent notices to all 179 investors,[5] none of whom disputed their claim amounts. The Receiver was appointed on January 8, 2016, meaning any

[5] One investor received more in distributions and commissions than he invested, one was bought out by the Receivership Entities prior to the Receiver's appointment, one cannot be located (despite using a private investigation firm to attempt to locate a current address), four investors were combined into one (due to wholly owned entities and a death), and a few other investors were combined as clarified during the claims process – leaving 171 investors with proposed allowed claims.

and all persons with claims against the Receivership Entities have had well over a year to contact the Receiver and assert those claims. The Receiver is not aware of any amounts owed to non-investors, such as trade creditors, taxing authorities or former employees. Defendant Ed Lichtig was the only person working for the Receivership Entities at the time of the Receiver's appointment and he conducted the Receivership Entities' operations from his home. Therefore, it is highly unlikely there are any unknown persons with valid claims at this point. Therefore, any claims submitted to the Receiver after March 1, 2017, should be automatically disallowed. Freitag Decl. ¶ 14.

C. <u>Interim Distributions</u>

The Receiver requests authority to make interim distributions to holders of allowed claims. As of March 31, 2017, there was approximately $2.2 million in (book balance) cash on hand in the receivership estate. Although pensioner overpayments (amounts paid in excess of lump sum advances) have been refunded and such payments are reflected in the March 31, 2017 book balance, the cash balance has grown steadily throughout the receivership as the Receiver has collected monthly payments from pensioners, distributions from pensioner bankruptcy estates, unused retainers from several law firms, stipulated judgment amounts from Defendants Lichtig and Hofelter, and payments on the Lynk Capital loan participation. The Receiver proposes that $2,904,157.72, the vast majority of cash on hand plus the $900,000 anticipated Lynk loan participation sale proceeds, be distributed at this time. The remaining cash, as well as continuing collections from pensioner payments, will be reserved and are anticipated to more than cover unpaid administrative expenses and those that will be incurred prior to conclusion of the receivership. Freitag Decl. ¶ 15.

As the case progresses, cash will continue to accumulate and likely exceed projections for administrative expenses (even factoring in a contingency reserve). Accordingly, and to provide for this, the Receiver requests authority to make subsequent interim distributions pursuant to the terms of the Distribution Plan. Such subsequent distributions will be made in the Receiver's discretion after providing notice to the Consumer Financial Protection Bureau ("CFPB") and the Superintendent for Financial Services for the State of New York ("Superintendent"). At all times, the Receiver will continue to reserve sufficient cash to cover projected administrative expenses through conclusion of the receivership. Freitag Decl. ¶ 16.

II. DISTRIBUTION PLAN

The Distribution Plan, attached as Exhibit C to the Freitag Declaration, lays out the Receiver's proposed distribution of receivership assets to holders of the 171 proposed allowed claims. The Distribution Plan provides for the establishment of a cash reserve, to cover allowed administrative expenses through completion of the receivership. The cash reserve will be all cash in the receivership estate other than what is authorized to be distributed. As noted above, the Distribution Plan provides for (a) pooling of receivership estate assets, (b) the rising tide method of calculating the actual amount of *pro rata* investor distributions to investors with allowed claims, and (c) automatic disallowance of claims received after March 1, 2017 (of which there are currently none). Finally, the Distribution Plan retains exclusive jurisdiction in the Court to resolve all matters relating to the Distribution Plan and receivership case in the event such issues arise after the case is closed.

III. ARGUMENT

"The power of a district court to impose a receivership or grant other forms of ancillary relief does not in the first instance depend on a statutory grant of power from the securities laws. Rather, the authority derives from the inherent power of a court of equity to fashion effective relief." *SEC v. Wencke*, 622 F.2d 1363, 1369 (9th Cir. 1980). The "primary purpose of equity receiverships is to promote orderly and efficient administration of the estate by the district court for the benefit of creditors." *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir 1986). As the appointment of a receiver is authorized by the broad equitable powers of the court, any distribution of assets must also be done equitably and fairly. *See SEC v. Elliot*, 953 F.2d 1560, 1569 (11th Cir. 1992).

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

> A district court's power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad. The district court has broad powers and wide discretion to determine the appropriate relief in an equity receivership. 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.

Id. (citations omitted); *see also CFTC v. Topworth Int'l, Ltd.*, 205 F.3d 1107, 1115 (9th Cir. 1999) ("This court affords 'broad deference' to the court's supervisory role, and 'we generally uphold reasonable procedures instituted by the district court that serve th[e] purpose' of orderly and efficient administration of the receivership for the benefit of creditors."). Accordingly, the Court has broad discretion in approving a plan of distribution and authorizing interim distributions.

A. <u>The Proposed Allowed Claim Amounts Should Be Approved</u>

The proposed allowed claim amounts reflected on Exhibit B to the Freitag Declaration are the Receiver's calculation of each investor's net loss, per the Claims Procedures Order. As noted above, none of the investors have disputed the proposed allowed amount of their claims after having 60 days to do so. Accordingly, the proposed allowed claim amounts, the critically important basis for the investor distributions, should be approved.

B. <u>The Distribution Plan Should Be Approved</u>

The Distribution Plan is designed to provide an orderly and fair distribution of receivership estate assets. Priority is given to fees and costs of the receivership approved by the Court and other administrative claims, as is always the case in federal equity receiverships. All other claimants will receive a *pro rata* distribution of cash in the receivership estate in accordance with the Distribution Plan terms, *i.e.* via the rising tide calculation method. Where the assets of a receivership estate are insufficient to pay all claims, *pro rata* is the most fair and equitable method of distributing receivership estate assets to similarly situated claimants. *See Capital Consultants*, 397 F.3d at 750; *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88-89 (2d Cir. 2002) (endorsing *pro rata* distribution of receivership assets). In this case, due to the wide variation in recovery to date – some investors have net losses of approximately 84% and others have net losses as low as 28% - the rising tide methodology attempts to equalize the investor recovery, providing distributions to those with greater losses first.

Additionally, to avoid unnecessary complication and expense in making distributions, the Distribution Plan provides that all claims submitted after March 1, 2017 (of which there are currently none) be automatically disallowed. The Receiver sent notices to all 179 investors, 171 of whom are allowed, and none of whom disputed their claim amounts. The Receiver was appointed on January 8, 2015, meaning any and all persons with claims against the Receivership Entities have had well over a year to contact the Receiver and assert those claims. The Receiver is not aware of any amounts owed to non-investors, such as trade creditors, taxing authorities or former employees. Defendant Ed Lichtig was the only person working for the Receivership Entities at the time of the Receiver's appointment and he conducted the Receivership Entities' operations from his home. Therefore, it is highly unlikely there are any unknown persons with valid claims at this point. Therefore, any claims submitted to the Receiver after March 1, 2017, should be automatically disallowed.

1. <u>The Receivership Entities' Assets Should Be Pooled For Distribution</u>

Where, as here, there is extensive commingling of cash involved in a scheme that violated federal and state laws, equity demands that assets of all Receivership Entities be pooled for purposes of distribution so as not to favor certain investors to the detriment of others. *See United States v. Real Property Located at 13328 and 13324 State Highway 75 North*, 89 F.3d 551 (9th Cir. 1996); *In re North American Coin & Currency LTD.*, 767 F.2d 1573 (9th Cir. 1985); *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80 (2d Cir. 2002); *SEC v. Forex Asset Mgmt., LLC*, 242 F.3d 325 (5th Cir. 2001).

Here, as detailed in the Receiver's Forensic Accounting Report and Recommendations (Dkt. No. 116), the Receivership Entities collected the full investor "purchase price," which was then used to fund (a) upfront, lump sum payments to pensioners, (b) commission and/or agency fee payments, (c) receivership entity management fee, life insurance and reserve impound accounts, and (d) receivership entity "profit." Notably, in the Buyer and Reserve Funds Agreement, it states that each buyer's (8 percent and 2.84 percent) contribution to the reserve funds are for the benefit of all buyers, providing combined resources for the buyer group; and that subject to the financial health of the reserve fund, the buyer gets 100 percent payout even if the pensioner redirects. As such and in practice, the Receivership Estate funds coming in from investors were pooled and commingled with the investor reserve funds, which have no direct tie to any individual investor/buyers.

As discussed above, when pensioners redirected their pension payments or otherwise defaulted, the Receivership Entities paid investors their contractual payments from the pooled reserve funds without regard to the source of the funds in the reserve account. Many pensioners defaulted, filed bankruptcy, or passed away. Therefore, many investors were regularly paid from the commingled/pooled reserve account. As mentioned in the Receiver's Forensic Accounting Report and Recommendations, assuming the January 2016 reserve account funds used to pay Investors monthly installments (approximately $80,000) persisted, the Receiver estimated the Receivership Entities' cash (the reserve funds) would have been depleted in or before August 2016.

Moreover, reserve funds were used to fund new contracts between the Receivership Entities and pensioners, creating pensioner contracts with no third-party investor directly associated with them. Finally, there is no evidence that investors performed independent investigation of the particular pensioner whose lump sum advance they were funding or that pensioner's creditworthiness. Instead, it appears investors simply relied on the Receivership Entities to match them with and check pensioner creditworthiness, and then invested based on the representations made to them by the Receivership Entities, including the guarantee that their monthly payments would be made (as long as there were sufficient reserve funds to make the payments).

Under these facts and circumstances, combined with the fact that some investors invested early and some later, the most fair and equitable manner of distributing receivership estate assets is to pool the assets and distribute them *pro rata* (via the rising tide method of calculation) to all investors with allowed claims. If, on the other hand, receivership estate funds were to be divided up on a contract-by-contract basis and investors received only what their pensioners happen to payback, some investors would receive very little (*e.g.*, investors whose pensioners defaulted shortly after funding) and other investors would recover the majority of their investment – the full lump sum the associated pensioner received. Moreover, as noted above, a substantial portion of the funds in the receivership estate (including the Lynk Capital loan participation interest, stipulated judgment amounts paid by Defendants Lichtig and Hofelter, and pensioner payments under contracts with the Receivership Entities) are not directly linked to any one investor and therefore must be pooled and distributed on a *pro rata* basis.

Accordingly, distributing receivership estate funds on a contract-by-contract basis would produce largely arbitrary and inequitable results in that some investors would globally receive substantially more than others. Accordingly, the proposed Distribution Plan provides that all receivership estate assets will be pooled and investors will receive distributions from the pool based on the allowed amount of their claims and the rising tide method.

2. The Rising Tide Method Should Be Approved

The Distribution Plan provides that amounts investors received from the Receivership Entities and/or pensioners prior to the Receiver's appointment be accounted for when calculating the rising tide method of *pro rata* distributions. This distribution method, known as the "rising tide" method, allows investors who received very little on account of their investments (or significantly less than other investors) to recover first. For the initial distribution, the Receiver proposes to distribute $2,904,157.72, which, under the rising tide method, will result in investors who received less than **53%** (or a net loss of greater than 47%) of their investment prior to the receivership receiving a distribution that brings them up to a total of 53%, including pre-receivership payments. Investors who received 53% or more of their contributions prior to the receivership will not participate in the initial distribution. However, as discussed below, subsequent distributions are expected, in which investors who received 53% or more prior to the receivership may participate.

In effect, this methodology levels the playing field and takes into account the disparate amounts received by investors prior to the receivership. This method has been endorsed by courts as a fair and equitable method of distributing receivership assets in fraud cases, especially where it results in only a small percentage of investors not sharing in the distribution. *See SEC v. Huber*, 702 F.3d 903 (7th Cir.

2012); *United States v. Cabe*, 311 F. Supp. 2d 501, 509 (D.S.C. 2003); *CFTC v. Wilson*, 2013 WL 3776902, *7 (S.D. Cal. July 17, 2013).

In *Huber*, the Seventh Circuit Court of Appeals compared the rising tide method to the net loss method and found that rising tide "appears to be the method most commonly used (and judicially approved) for apportioning receivership assets." *Huber*, 702 F.3d at 906; *see also Wilson*, 2013 WL 3776902, at 7 ("the Court concludes the Rising Tide Method is the most equitable remedy available"). The Seventh Circuit went on to say:

> The more investors in a Ponzi scheme there are who would receive nothing under rising tide and might therefore have difficulty paying their future expenses, the more likely the net loss method is to maximize the overall utility of the investors. But only 18 percent of the investors in Huber's scheme receive nothing under rising tide, and so in this case that method is an acceptable alternative to net loss.

Huber, 702 F.3d at 907.

Here, those investors who received the least returns from the Receivership Entities (*e.g.*, the later investors who received approximately 16% (or lost 84%) of their investment) will receive a greater percentage of the receivership estate distribution than those investors who received substantially more from the funds (*e.g.*, the early investors who already received approximately 72% (or lost 18%) of their investment). Only 42 investors who would receive a distribution under the net loss method (because they received pre-receivership distributions totaling less than 100% of their investment), will not receive a payment from the initial distribution under the rising tide method. That is about 25% of the total investors with allowed claims (171). In comparison to the net loss method, the rising tide method, for the initial distribution, reallocates $654,337.26 from investors who previously recovered 53% or more of their investment to investors who previously recovered less than 53% of their investment. This has the effect of reducing the highest investor loss after the initial round of distributions are made from nearly 66% (if calculated via the net loss method) to 47% (when calculated via the rising tide method) of the amount invested.

Moreover, this is only an initial distribution. Some of the 42 investors who will not receive a distribution initially will likely receive a distribution when subsequent distributions are made as the total *pro rata* distribution from the receivership estate rises above the total of their pre-receivership distributions. For example, if an investor invested $100,000 with the Receivership Entities and received payments totaling $54,000 (or 54%) prior to the receivership, such investor would not receive a distribution in the initial round. As discussed above, the initial distribution will bring all investor recoveries up to 53% of their total investment(s). However, the Receiver anticipates ongoing collections from pensioners will generate additional cash to distribute. If, hypothetically, the Receiver is able to distribute another $400,000 (which amount is by no means certain), then all investors who received less than approximately 55.3% of their investment(s) prior to the Receiver's appointment will participate. In this scenario, the hypothetical investor discussed above would receive a distribution of approximately $1,300 such that the total recovery, including pre-receivership and post-receivership distributions, would be $55,300 ($54,000 plus $1,300 = $55,300), or 55.3% of his or her investment. Overall, the effect of this hypothetical second distribution of $400,000 would be that only 32 (or 19%) of investors who would receive a distribution under the net loss method will not participate.

Accordingly, the rising tide method is the most fair and equitable way to distribute receivership estate assets under the facts and circumstances of this case and should be approved by the Court.

C. <u>The Receiver Should Be Authorized To Make Interim Distributions</u>

The Distribution Plan proposes an interim distribution be made as soon as practicable and provides for the creation of a cash reserve. As of March 31, 2017, there was a total of approximately $2.2 million on hand in the estate. The Receiver proposes a total of $2,904,157.72, the vast majority of cash on hand plus the $900,000 anticipated Lynk loan participation sale proceeds, be distributed at this time. The remaining cash, as well as all amounts collected and recovered going forward, will go into a cash reserve. The cash reserve, as with all cash in the receivership estate, will be maintained in federally-insured bank accounts.

The total cash on hand has grown steadily through the receivership, despite the return of pensioner overpayments (the amounts paid in excess of lump sum payments) to the applicable pensioners. The starting cash balance was approximately $526,000. The Receiver has been able to increase the cash balance by more than $2.5 million over the past 15 months (including the anticipated Lynk loan participation sale). The Receiver expects the cash balance to continue to increase from ongoing pensioner collections.

Accordingly, the Receiver requests authority to make subsequent interim distributions such that, as administration of the receivership moves closer to completion, the Receiver can review actual and projected administrative expenses and evaluate the amount necessary to cover those expenses through conclusion of the receivership. When it becomes clear the cash reserve (including cash coming in on a going forward basis) will exceed administrative expenses to a safe degree, which the Receiver believes it will, she will notify the CFPB and the Superintendent of her intention to make a further distribution, and, assuming the CFPB and Superintendent have no objection, will issue distribution payments. Each round of interim distributions involves administrative expenses associated with processing, mailing, and tracking distribution checks. Accordingly, the Receiver will not make further interim distributions unless she is confident that at least $400,000 can be distributed without putting the receivership estate at risk.

IV. CONCLUSION

Based on the foregoing, the Receiver requests an order (a) approving the proposed allowed claim amounts attached to the Freitag Declaration as Exhibit B (b) approving the Distribution Plan attached to the Freitag Declaration as Exhibit C, (c) authorizing the Receiver to make an initial round of interim distributions totaling $2,904,157.72, (d) authorizing the Receiver to make subsequent interim distributions in her discretion (with notice to and approval of the CFPB and Superintendent), and (e) automatically disallowing any and all claims submitted to the Receiver after March 1, 2017.

Dated: April 25, 2017

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