
UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No. 8:15-cv-01329-JLS-JCG

Date: May 31, 2017

Title: Consumer Financial Protection Bureau et al. v. Pension Funding, LLC et al.

Present: **Honorable JOSEPHINE L. STATON, UNITED STATES DISTRICT JUDGE**

Terry Guerreo
Deputy Clerk

N/A
Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFF: ATTORNEYS PRESENT FOR DEFENDANT:

Not Present

Not Present

PROCEEDINGS: (IN CHAMBERS) ORDER GRANTING MOTION FOR (1) APPROVAL OF PROPOSED ALLOWED CLAIM AMOUNTS, (2) APPROVAL OF DISTRIBUTION PLAN, AND (3) AUTHORITY TO MAKE INTERIM DISTRIBUTIONS (Doc. 139)

Before the Court is an unopposed Motion for (1) Approval of Proposed Allowed Claim Amounts, (2) Approval of Distribution Plan, and (3) Authority to Make Interim Distributions filed by Receiver Krista L. Freitag. (Mot., Doc. 139.) The Court finds this matter appropriate for disposition without oral argument. Fed. R. Civ. P. 78(b); C.D. Cal. R. 7-15. Accordingly, the hearing scheduled for June 2, 2017 at 2:30 p.m. is VACATED.

On December 14, 2016, the Court generally approved of the Receiver’s Report and Recommendations to unwind the receivership entities. (Order, Doc. 125.) Pensioners would be required to pay back the full amount borrowed but would not have to pay back any of the hidden interest. (*Id.* at 5-6.) The Receiver would send Investors a letter stating how much, according to the Receiver’s calculations, each Investor had transferred to the receivership entities and received in return. (*Id.* at 6-7.) Investors would have sixty days to submit documentation to challenge the Receiver’s calculations. (*Id.* at 6.) On January 4, 2017, the Court selected Magistrate Judge Karen E. Scott to resolve any disputes between Investors and the Receiver. (*Ex Parte* Order, Doc. 128.)

After the Court approved the Receiver’s recommendations, the Receiver mailed letters to each of the Investors stating in plain English the Investor’s balance and how the Investor could challenge the Receiver’s determination. (Letter, Exh. A, Doc. 139-1.) About twenty Investors responded to the letters, but none ultimately challenged the

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Receiver's calculations. (Freitag Decl. ¶ 3, Doc. 139-1.) The Receiver now seeks to distribute the receivership entities' assets based on the "rising tide" method, meaning that Receiver would disburse funds to equalize Investors' losses. (*Id.* ¶¶ 11, 13) At this time, the Receiver concludes that she can disburse \$2,904,157.72, so that Investors will recover at least 53% of their contributions. (*Id.* ¶ 12.) Those who have already received more than 53% of their contributions will not receive a share of the disbursement but will not have to return the amount they have received beyond this threshold either. (*Id.*) The \$2,904,157.72 represents the vast majority of the receivership entities' current cash balance (about \$2.2 million) and proceeds from the Lynk Investments transaction (\$900,000). (*Id.* ¶ 15.) As cash continues to accumulate, the Receiver intends to make additional distributions under the same rising tide method. (*Id.* ¶ 16.) The Receiver also seeks to bar all claims submitted after March 1, 2017. (*Id.* ¶ 14.) The Receiver was appointed over a year ago, on January 8, 2016, and has no evidence of other Investors or trade creditors. (*Id.*) The Receiver submits a Plan of Distribution implementing her recommendations as well as a list of every Investor's contribution, pre-receivership distributions, and the amount received under the proposed initial distribution. (Distribution Plan, Exh. C, Doc. 139-1; Claimant List, Exh. A, Doc. 139-1.)

The Receiver contends that, considering the receivership entities' assets and the disparities in Investors' losses, the "rising tide" method is the best way to distribute the funds. (Freitag Decl. ¶¶ 9-14.) As part of each Pensioner-Investor transaction, Investors made contributions to pooled reserve funds that were available for the benefit of all Investors. (*Id.* ¶¶ 5, 6.) Some of these reserve funds were also used to invest in other Pensioner transactions, resulting in Pensioner-Investor transactions that are not associated with any particular third-party Investor. (*Id.* ¶ 7.) Several of the receivership's largest assets—the proceeds of the Lynk Investments transaction and the stipulated judgments against Defendants Lichtig and Hofelter—are not tied to any Investor. (*Id.* ¶ 8.) The Receiver has found no evidence that Investors performed independent due diligence about the credit worthiness of the particular Pensioners that the receivership entities assigned them. In addition, there are wide variations in Investors' losses. (*Id.* ¶ 7.) Early investors have recovered approximately 72% of their contributions while late investors have recouped only about 16%. (*Id.* ¶ 10.)

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Finally, the Receiver seek authorization to make additional disbursements under the Distribution Plan. (*Id.* ¶ 16.) The receivership entities’ cash reserves are expected to grow as Pensioners continue to make payments, and the Receiver expects to be able to make additional disbursements as the receivership concludes by projecting anticipated administrative expenses. (*Id.* ¶¶ 15-16.) The Receiver will obtain the approval of the CFPB and Superintendent before making any disbursement and, because of the costs associated with processing a distribution, will not make a disbursement of less than \$400,000. (Mem. at 16, Doc. 139.)¶

“[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.” *SEC v. Capital Consultants, LLC*, 397 F.3d 733, 738 (9th Cir. 2005) (alteration in original) (citation omitted). These broad powers include the authority to determine the appropriate method for distributing the receivership’s assets. *See generally id.* Where assets have been comingled or tracing would result in unwarranted discrepancies in the amount recovered by different investors, equity favors a *pro rata* distribution. *See id.* at 88-89; *United States v. Real Prop. Located at 13328 & 13324 State Highway 75 N., Blaine Cty., Idaho*, 89 F.3d 551, 554 (9th Cir. 1996). The two leading approaches for distributing receivership assets are the net loss and rising tide methods. The net loss method subtracts each investor’s prior disbursements before applying a uniform *pro rata* multiplier. *SEC v. Byers*, 637 F. Supp. 2d 166, 172 (S.D.N.Y. 2009), *aff’d sub nom. SEC v. Malek*, 397 F. App’x 711 (2d Cir. 2010), and *aff’d sub nom. SEC v. Orgel*, 407 F. App’x 504 (2d Cir. 2010). By contrast, under the rising tide method, investors do not receive a distribution unless there are sufficient funds for all investors to recover that percentage of their investment. (Freitag Decl. ¶ 13.) The rising tide method “appears to be the method most commonly used (and judicially approved) for apportioning receivership assets.” *SEC v. Huber*, 702 F.3d 903, 906 (7th Cir. 2012); *see, e.g., CFTC v. Wilson*, No. 11-CV-1651-GPC-BLM, 2013 WL 3776902, at *7 (S.D. Cal. July 17, 2013); *CFTC v. Lake Shore Asset Mgmt. Ltd.*, No. 07C3598, 2010 WL 960362, at *10 (N.D. Ill. Mar. 15, 2010), *aff’d sub nom. Commodity Futures Trading Comm’n v. Lake Shore Asset Mgmt. Ltd.*, 646 F.3d 401 (7th Cir. 2011); *SEC v. Par.*, No. 2:07-CV-00919-DCN, 2010 WL 5394736, at *8 (D.S.C. Feb. 10, 2010). Here, only about a quarter of investors who

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would receive distributions under the net loss method would not receive any sum under the rising tide method. (Mem. at 14.) Under future disbursements, some of these investors may qualify for a disbursement. (*Id.* at 15.) Further, applying the net loss method would perpetuate the arbitrary differences in the amount recouped by different Investors. Investors apparently did not exercise independent judgment in selecting Pensioners and contributed to pooled reserve accounts that were available for the benefit of all Investors in case of default. (Freitag Decl. ¶ 7.) While some Investors will not receive anything under the Receiver’s initial disbursement, this simply reflects these Investors’ greater pre-receivership recovery on their investments.

The Court likewise agrees that granting the Receiver the authority to make additional distributions would be in the best interest of the receivership by streamlining the distribution process and reducing costs.

IT IS HEREBY ORDERED THAT:

1. The Receiver’s Motion is GRANTED;
2. The proposed allowed claim amounts as listed on Exhibit B to the Receiver’s declaration are APPROVED;
3. The Distribution Plan attached as Exhibit C to the Receiver’s declaration is APPROVED;
4. The Receiver is authorized to make an initial round of interim distributions totaling \$2,904,157.72;
5. The Receiver is authorized to make subsequent interim distributions in her discretion (with notice to and approval of the Consumer Financial Protection Bureau and Superintendent of Financial Services of the State of New York); and
6. Any and all claims submitted to the Receiver after March 1, 2017 are hereby disallowed.

Initials of Preparer: tg