UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
(MIAMI DIVISION)

CASE NO. 06-20975-CIV-HUCK / SIMONTON

SECURITIES AND EXCHANGE COMMISSION,	)
	)
Plaintiff,	)
	)
v.	)
	)
JACK P. UTSICK, ROBERT YEAGER, DONNA YEAGER, WORLDWIDE ENTERTAINMENT, INC., THE ENTERTAINMENT GROUP FUND, INC., AMERICAN ENTERPRISES, INC., AND ENTERTAINMENT FUNDS, INC.	)
	)
Defendants.	)
	)

RECEIVER'S MOTION TO ESTABLISH (i) A CLAIMS MECHANISM TO CALCULATE INVESTORS' CLAIMS; (ii) A CLAIMS PROCEDURE TO DEAL WITH DISPUTED CLAIMS; AND (iii) A CLAIMS BAR DATE

Michael I. Goldberg ("Receiver"), in his capacity as Receiver of Worldwide Entertainment, Inc., The Entertainment Group Fund, Inc., American Enterprises, Inc., and Entertainment Funds, Inc., hereby files this Motion to Establish (i) A Claims Mechanism to Calculate Investors' Claims; (ii) A Claims Procedure to Deal with Disputed Claims; and (iii) A Claims Bar Date. In support of this Motion, the Receiver directs this Court to the following memorandum and states as follows:

I. INTRODUCTION

This case involves the administration of a federal equity receivership. At this point in the receivership, the Receiver would like to begin developing an appropriate equitable claims procedure for interim distribution(s) to the investors. However, as discussed in detail below, this is a sensitive and complicated task for which there are no set rules. The task in this case is

further complicated by the fact that this case differs from the typical cases in which this Receiver has previously been involved and those cases which are generally discussed in the case-law regarding federal equity receiverships. Unlike those other more typical cases, the Receiver believes this case involves businesses that began as legitimate and profitable businesses. Most significantly, some of the businesses involved in this receivership have been in business for over twenty (20) years, with some investors invested the same many years. Moreover, although the forensic analysis has not yet been completed, based on preliminary reports the Receiver believes that at some point in time the underlying businesses became unprofitable, and therefore investor returns were necessarily paid in part from other investors' principal. Accordingly, the Receiver is respectfully requesting guidance from this Court in selecting an appropriate equitable claims procedure for interim distribution(s) to investors. In this regard, the Receiver has set forth in this Memorandum the relevant case-law regarding developing a claims process in a federal equity receivership along with examples demonstrating the various methods that have been considered by other federal equity receivership courts.

II. BACKGROUND OF THE RECEIVERSHIP ENTITIES

Worldwide Entertainment, Inc. ("Worldwide") and The Entertainment Group Fund, Inc. ("TEGFI") are corporations owned by Jack Utsick ("Utsick"). *See* Initial Report of Receiver, Michael I. Goldberg Concerning the Condition of the Entertainment Group Fund, Inc. and Worldwide Entertainment, Inc. dated March 1, 2006 ("Receiver's 1st Report") at p. 2. Worldwide and TEGFI were engaged in all facets of the entertainment business, including concert promotion, venue ownership and operation, entertainment product development and miscellaneous investments. *See* Receiver's 1st Report at p. 8. Robert Yeager and Donna Yeager are the principals of American Enterprises, Inc. ("AEI") (Worldwide TEGFI, AEI, Entertainment

Funds, Inc. ("EFI"), their subsidiaries, successors and assigns are hereafter collectively referred to as the "Receivership Entities"). *See* Receiver's Second Report Concerning the Condition of The Entertainment Group Fund, Inc., Worldwide Entertainment, Inc., American Enterprises, Inc. and Entertainment Funds, Inc. dated July 19, 2006 ("Receiver's 2nd Report") at p. 4. Although the forensic examination has not yet been completed, it is currently believed that there are approximately 3,300 investors who, over the years, invested over $400 million into Worldwide and/or TEGFI, either directly or through AEI and that there is in excess of $100 million owed to these investors. *See* Receiver's 1st Report at p. 3.

A. Fundraising

Worldwide and TEGFI raised money directly from hundreds of investors, in large part, based upon the projection of twenty percent (20%), or higher, annual returns. *See* Receiver's 1st Report at p. 3. The Receiver believes that between $50 and $100 million was invested directly with Worldwide and TEGFI. *Id.* In addition, it is believed that approximately 2,000 investors invested money in Worldwide and TEGFI through AEI and its affiliates. *Id.* Typically limited liability companies ("LLC" or "LLCs") were formed by AEI for a particular project or type of projects with AEI serving as the manager of the newly formed LLC. *See* Receiver's 1st Report at p. 4. Funds were raised by offering unit-holders significant rates of return on investments. *See* Receiver's 2nd Report at p. 51. The terms varied from program to program but a typical arrangement provided that the LLC would enter into a business loan agreement with Worldwide for a specific project. *See* Receiver's 1st Report at p. 4. Under the terms of the loan agreement, the LLC received eighteen percent (18%) interest on its loan plus an additional three percent (3%) of any "profits" generated on the project. *Id.* The loan agreement further required Worldwide to reimburse the LLC for operating expenses up to a certain amount based on the

profits made by Worldwide. *Id.* Typically, LLCs sold units to purported qualified investors pursuant to a private placement of securities. *Id.*

Moreover, there were also investors who utilized their individual retirement accounts ("IRA") accounts as the vehicle by which to make investments. *See* Receiver's 1st Report at p. 5. IRA investors had their funds handled by American National Pension Services ("ANPS") of Miami. *Id.* It appears that over time, there were hundreds of investors who invested more than $100 million in retirement funds into Worldwide through ANPS. Based upon the preliminary analysis, it is unclear which investors were repaid and what is currently owed this group of IRA investors and ANPS. *See* Receiver's 1st Report at p. 5-6.

B. Record-Keeping and Commingled Accounts

The task of analyzing the amounts owed to each investor is complicated by the record-keeping and corporate practices of the Receivership Entities. Although AEI's records appear to be organized and well maintained in an access database, (*see* Receiver's 1st Report at p. 6, Receiver's 2nd Report at p. 51), it is nonetheless difficult to verify the accuracy of balances brought forward on closed projects because when monies were due to an investor, rather than accepting payment, that money might be reinvested in another program. *See* Receiver's 1st Report at p. 6. Since money was "rolled over" in this fashion from prior closed projects, further calculations must be made as to exactly what is owed to investors who put funds into the AEI/ Worldwide/TEGFI programs. *Id.* Preliminarily, the database that has been examined, although not yet verified, indicates the existence of thousands of investors representing approximately $135 million in net invested capital (inclusive of rollover balances brought forward). *See* Receiver's 1st Report at p. 6, Receiver's 2nd Report at p. 52.

The task of analyzing the amounts owed is further complicated by the fact that the bookkeeping and corporate practices of Worldwide and TEGFI can best be described as a mess. *See* Receiver's 1st Report at p. 7. For example, a preliminary analysis of the books and records provided by AEI, Worldwide and TEGFI reveal instances where certain AEI loans were repaid by both Worldwide and TEGFI and instances where a single LLC funded both Worldwide and TEGFI projects. *See* Receiver's 1st Report at p. 5. A review of Worldwide and TEGFI's financial records, which appear to be incomplete, indicate that there were common investors and funding sources, common assets, liabilities and transactions with various companies and various projects. *Id.*

Although most of the investors' investments were supposed to be tied to specific projects or groups of projects placed in separate escrow accounts, in reality, all investors' funds were commingled into a few main accounts together with proceeds from some projects. *See* Receiver's 1st Report at p. 7. From these few accounts, money was withdrawn, on an as-needed basis, to fund the various business ventures and operating costs of Worldwide and TEGFI and to pay investor returns. *Id.* Corporate formalities between Worldwide and TEGFI were completely ignored and money was routinely taken from these accounts and transferred to various projects without a proper accounting. *Id.* Simply put, Worldwide and TEGFI lacked the most rudimentary financial controls one would expect of entities handling millions of dollars of other people's funds, including retirement funds, and there is no possible way to discern one individual investor's money from another investor's money. *Id.*

C. Past Performances of the Receivership Entities

Over the years, Worldwide and TEGFI invested millions of dollars in numerous ventures throughout the United States and the world either directly or through their affiliates or joint

venture partners. *See* Receiver's 1st Report at p. 6. Although many of the investments made by Worldwide and TEGFI were profitable, many of the ventures also proved unprofitable and in the aggregate Worldwide and TEGFI lost millions of dollars. *Id.* Therefore, it does not appear that Worldwide and TEGFI, either by themselves or their affiliates, generated sufficient, if any, profit as a whole to support the return of principal, interest and/or "profits" that were paid to the investors. *Id.* Yet, Worldwide and TEGFI continued to honor investors' notes and the Receiver preliminarily believes that "profit" paid to investors could only have come from money raised from new investors. *Id.* Some investors "cashed out" their investments while other elected to "roll over" their investments into new ventures. *Id.* Until all analysis is complete, it is impossible to determine the exact amount of money currently owed to each of the investors. *See* Receiver's 1st Report at p. 6-7. Moreover, any such competent analysis will likely take months and cost the estate hundreds of thousands of dollars. Finally, it is important to note that at this point in time, there has not been a formal finding of wrongdoing in this case.

III. DISCUSSION

In situations such as appears to be the case in this receivership, where the amount of purported claims of the investors exceeds the funds available for distribution to the claimants, a court is obligated to devise an equitable system of distribution with the goal of treating each victim of the investment fairly and as nearly equal as is possible. *See U.S. v. Cabe*, 311 F. Supp. 2d 501, 504 (D.S.C. 2003). The discussion below shall examine how the case-law involving federal equity receiverships has approached this issue. Further, this memorandum shall also set forth examples of how certain systems of distribution would impact several hypothetical classes of investors in order to demonstrate the consequences of adopting certain possible systems of distribution.

A. Analysis of Case-Law Regarding the Distribution of Assets in a Federal Equity Receivership

1. District Court has Broad Powers and Wide Discretion to Determine Relief in Equity Receiverships.

It is appropriate for a receiver to seek guidance from a court regarding a matter of such import and wide discretion as devising a claims process in an equity receivership. As has been noted, "[i]t is the court itself which has the care of the property in dispute ... [and the] receiver is but the creature of the court." *S.E.C. v. Safety Finance Service, Inc.,* 674 F. 2d 368, 373 (5th Cir. 1982). It has further been observed that "[i]n accepting or rejecting the claims of creditors, as well as in filing a report of findings of fact and conclusions of law, a receiver acts like a master ... [and] a district court must decide de novo all objections to findings of fact and conclusions of law made or recommended by a master before ruling on the master's recommendations (citations omitted)." *U.S. v. Fairway Capital Corp.,* -- F. Supp. --, 2006 WL 1554593 at *2 (D.R.I. 2006). Moreover, guidance from a court based on the facts and circumstances of a particular case would be especially helpful to a receiver because "case law involving district court administration of an equity receivership (once the receivership is underway) is sparse and is usually limited to the facts of the particular case." *S.E.C. v. Hardy*, 803 F. 2d 1034, 1037 (9th Cir. 1986).

One principle that has been consistently recognized is that the district court has extremely broad powers and wide discretion to determine relief in equity receiverships. *See e.g. S.E.C. v. Capital Consultants LLC*, 397 F. 3d 733, 738 (9th Cir. 2005); *SEC v. Basic Energy & Affiliated Resources Inc.*, 273 F. 3d 657, 668 (6th Cir. 2001); *S.E.C. v. Elliott,* 953 F.2d 1560, 1566 (11th Cir. 1992), *rev'd in part on other grounds,* 998 F. 2d 922 (11th Cir. 1993). 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. *See Capital Consultants*, 397 F. 3d at 738; *Hardy*, 803 F. 2d at 1037 (because a district judge supervising an equity receivership faces a myriad of complicated problems in dealing with the various parties and issues involved in administering the receivership, then reasonable administrative procedures, crafted to deal with the complex circumstances of each case, will be upheld). Accordingly, a district court's decisions relating to the choice of a distribution plan for the receivership are reviewed for abuse of discretion. *See S.E.C. v. Credit Bancorp Ltd.*, 290 F. 3d 80, 87 (2d Cir. 2002); *Elliott,* 953 F.2d at 1569-70; *Hardy,* 803 F. 2d at 1037-8.

2. Due Process

a. Summary proceedings

Whatever remedy a district court ultimately chooses as an equitable distribution plan must take into consideration the due process rights of claimants. In general, investors may have some due process rights in the distribution plan of a receivership, although there are no specific standards or rules setting forth precisely what rights such investors would have to participate in such a proceeding. *See S.E.C. v. TLC Investments and Trade Co.,* 147 F. Supp. 2d 1031, 1034 (C.D. Cal. 2001). In the context of the formulation of an equitable distribution plan, due process requires notice and an opportunity to be heard. *See generally Elliott,* 953 F.2d at 1566.

The use of summary proceedings is permissible in the formulation and implementation of a distribution plan so long as those affected are afforded adequate notice and an opportunity to be heard. *See S.E.C v. Credit Bancorp,* 124 F. Supp. 2d 824, 828 (S.D.N.Y. 2000)("[i]ncluded within the court's powers in administering the receivership estate and fashioning appropriate equitable relief is the discretion to use summary proceedings, so long as those affected are afforded adequate notice and an opportunity to be heard"); *Elliott,* 953 F.2d at 1566 -1567 (in

granting relief, it is appropriate for the district court to use summary proceedings so long as the parties are provided with notice and an opportunity to be heard when the facts are in dispute); *Hardy*, 803 F. 2d at 1040 (approval of the claims procedures used in a receivership case when all claimants were given reasonable notice and opportunities to be heard at hearings). Summary proceedings are not only permissible in this context, but may actually be preferable because the use of such proceedings reduces the time necessary to settle disputes, decreases litigation costs and prevents further dissipation of the receivership assets. *See Elliott*, 953 F.2d at 1566; *S.E.C v. Wencke*, 783 F. 2d 829, 837 (9th Cir. 1986). "Indeed, summary proceedings have the salutary effect ... of preventing further dissipation of the receivership assets through unnecessary litigation costs and promoting judicial efficiency." *Credit Bancorp*, 124 F. Supp. 2d at 828. Thus, the *Elliott* court required claimants that objected to the use of summary proceedings to show "how they would have been better able to defend their interests in a plenary proceeding." *Elliott,* 953 F.2d at 1567.

b. Proposed Claims Procedure to Deal with Disputed Claims and Claims Bar Date

An example of a claims procedures that has been held to adequately protect the due process rights of investors in determining the amount of their claims included the following steps: i) the receiver initially contacted investors with a suggestion as to the amount of their claim, based on the receiver's reconstruction of the entities' records; ii) if an investor disagreed with that amount, he or she could inform the receiver and ask for re-evaluation; and iii) if the receiver and the investor are not able to agree on the amount of the investor's claim, the investor could seek review from the receivership court. *See TLC Investments.*, 147 F. Supp 2d at 1037.

Thus, based on the foregoing, and subject to this Court's recommendations and/or approval, the following procedures proposed by the Receiver should satisfy due process

concerns. The Receiver proposes to identify each investor in this case by reviewing the records of the Receivership Entities and posting a notice on the website www.entertainmentgroupinfo.com. If this Court deems it appropriate, the Receiver could also place notice in certain publication(s) publicizing the pendency of this receivership and requesting that all persons who may have a claim file a claim by the claims bar date to be specified.[1] The Receiver will distribute a claim form to each known investor by U.S. Mail and by posting the claim form on the receivership website. Each investor will be required to complete and return the claim form to the Receiver by the specified claims bar date. The Receiver proposes that this Court set a claims bar date which will allow the investors sufficient time to complete and to file their claim with the Receiver. The Receiver respectfully suggests that a claims bar date of December 15, 2006 should be more than enough time for claimants to complete and file their claim. The Receiver further proposes that any claim not filed on or before the claims bar date be extinguished.

Subsequent to the claims bar date, the Receiver proposes to verify all filed claims and gather information regarding each investor's purported claim based on a review of the Receivership Entities' business records to the extent such review is feasible and not overly burdensome. If the claims filed are in accord with the Receivership Entities' books and records, those claims will be approved and allowed by the Receiver. In the cases where the Receiver and an investor are not able to agree on the amount of that investor's claim, and those disputed claims cannot be resolved by agreement, the Receiver proposes that the Court establish a claims administration procedure to deal with any and all disputed investor claims in a fair and efficient manner and in a manner which provides each claimant with notice and opportunity to be heard.

[1] Due to the fact that a majority of investors are airline pilots, the Court may direct the Receiver to publish notice of the receivership in a leading pilot association trade journal.

To that end, if the Receiver and claimant are unable to resolve the dispute, the Court could authorize and direct as follows:[2]

(a) The Receiver will file with the Court and serve by U.S. Mail to each claimant with a claim that is inconsistent with the Receiver's determinations, a formal notice outlining the Receiver's objection and advising each claimant of the suggested amount of their claim as determined by the Receiver;

(b) In the event that any claimant objects to the amount of their claim, as suggested by the Receiver, then such claimant will have thirty (30) days from the date of the service of the Receiver's notice to file with this Court and serve on the Receiver a written objection to the Receiver's proposed claim amount which sets forth the amount claimed by the claimant and the basis for the claimant's dispute with the amount proposed by the Receiver;

(c) Any claimant who fails to file and serve a timely objection shall be deemed to have waived their objection and the final amount of their claim shall be set at the amount as determined by the Receiver; and

(d) With respect to those claimants, if any, who timely file and serve a written objection to the amount of their claim as determined by the Receiver, the Receiver proposes that the Court schedule a status conference to discuss the best procedures for resolution of those claim disputes.

Thus, the implementation of these procedures as proposed by the Receiver, or any other similar procedures which may be set by this Court, should adequately protect the due process rights of the investors in this case.

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[2] The Receiver points out that the following is the same procedure utilized by the Receiver in other cases.

3. General Principles to Consider in Devising an Equitable System of Distribution

In addition to determining the identity of the investors and the amounts of their purported claims, a plan must be devised in order to determine what percentage of the assets of the receivership estate is to be distributed to each of the investors. As to the choice of a particular method for distributing the funds, "[n]o specific distribution scheme is mandated so long as the distribution is 'fair and equitable.'" *S.E.C v. P.B. Ventures,* 1991 WL 269982 at *2 (E.D. Pa. 1991).

a. "Equality is Equity"

In deciding how receivership assets should be distributed to investors, "the fundamental principle which emerges from [the] case law is that any distribution should be done equitably and fairly, with similarly-situated investors or customers treated alike." *S.E.C v. Credit Bancorp Ltd.,* 2000 WL 1752979 at *13 (S.D.N.Y. 2000). Equity demands equal treatment of victims in a factually similar case. *See e.g. Capital Consultants*, 397 F. 3d at 738-739; *S.E.C v. Drucker*, 318 F. Supp. 2d 1205 (N.D. Ga. 2004). *U.S v. Real Property Located at 13328 and 13324 State Highway 75 Nort*h, 89 F. 3d 551 (9th Cir. 1996). Since investors generally occupy the same legal position as other investors, equity should not permit them a preference over another investor for "equality is equity". *See Elliott,* 953 F. 2d at 1570 *quoting from Cunningham v. Brown*, 265 U.S. 1, 44 S. Ct. 424, 427, 68 L. Ed. 873 (1924).

b. Sensitive Nature of this Undertaking ("Equitable" Might Not be Well-Liked by All)

The task of formulating a proper distribution plan is a sensitive undertaking because a plan that is "equitable" might not necessarily be popular with all investors. Essentially, a

receiver and an investor have the same goal which is to maximize the distribution to investors. *TLC Investments*, 147 F. Supp. 2d at 1041-2. Yet, as one court has observed:

> [T]his is a case in which numerous victims of a fraud have competing claims to a limited receivership res. The relief sought by [certain investors] would come at the direct expense of the other…victims…. [T]he Receiver at once represents the interests of all and none of the [investors]---To the extent that the Receiver has the interest of all in mind, he is the adversary of the individual customer - whose concern is only for the return of his deposits. (internal quotations omitted).

Credit Bancorp, 2000 WL 1752979 at * 19. The court in *Credit Bancorp* further observed that "[o]f course, where the assets of the receivership estate are insufficient to afford full recovery to all victims, any given plan is likely to be viewed more favorably by certain victims than others depending on how they fare under that plan …An equitable plan is not necessarily a plan that everyone will like." *Id.* at * 29.

Similarly, this difficulty was discussed by another court which noted that "[w]e are faced here with the problem of a small pie and many disappointed investors. Every investor who responded to the Plan urges that we authorize a 'fair' distribution, but there was a sharp split of opinion as to what that means in this case." *C.F.T.C. v. Hoffberg,* 1993 WL 441984 at * 2 (N.D. Ill. 1993). *See also TLC Investments*, 147 F. Supp. 2d at 1041-2 (in any situation in which the pie is limited, each individual desiring a slice of that pie is, in a sense, adverse to others also wanting a slice of the pie); *S.E.C. v. Credit Bancorp Ltd.*, 194 F.R.D. 457, 462-3 (S.D.N.Y. 2000)("[c]ertain …customers have made rather clear their individual desires that 'Peter' not be robbed to pay 'Paul' because of any fraud perpetrated by [the receivership entity]… However …it is not altogether clear at this point who are the 'Peters" and who are the 'Pauls' in this affair").

However, there must be more than a concern of not faring as well as another investor in order to demonstrate why certain investors are situated any differently from any other investors

so that they should be treated differently from the other investors. *See Credit Bancorp,* 2000 WL 1752979 at * 35-37 (all investors were similarly situated in that they all relied on assurances from the corporation and all were defrauded). An equitable plan will not necessarily be better for each and every investor than any other plan since each investor will fare differently under different plans. *Id.* Thus, since equity demands equal treatment of investors in a factually similar case, *see e.g. Capital Consultants*, 397 F. 3d at 738-739, and, since all the investors in the present case should be considered to occupy the same legal position as other investors, then therefore equity should not permit any individual investor in this case any preferential treatment over any another investor for "equality is equity". *See generally Elliott,* 953 F. 2d at 1570.

c. Pro-Rata Distribution Versus a Traced Asset Calculation

A distribution system can be based on either a pro rata distribution to each investor or a traced asset calculation based on each investor's segregated account. The traced asset option has generally been disfavored in federal equity receivership cases because it permits one claimant to recover at the expense of another merely because the former has the good fortune of being able to trace his or her funds. *See generally C.F.T.C. v. Equity Financial Group LLC*, 2005 U.S. Dist. LEXIS 20001 at * 78 (D.N.J. 2005); *Liberte Capital Group v. Capwill,* 229 F. Supp. 2d 799, 804-805 (N.D. Ohio 2002); *Credit Bancorp*, 194 F.R.D. at 464. As the court in *Elliott* explained:

> To allow any individual to elevate his position over that of other investors similarly 'victimized' by asserting claims for restitution and/ or reclamation of specific assets based upon equitable theories of relief such as fraud, misrepresentation, theft, etc. would create inequitable results, in that certain investors would recoup 100% of their investment while others would receive substantially less…[I]n the context of this receivership, the remedy of restitution to various investors seeking to trace and reclaim specific assets as originating with them is disallowed as an inappropriate equitable remedy.

Elliott, 953 F. 2d at 1569. Even in cases where the tracing method could otherwise be employed but would result in relief for some, but not all, parties, courts have tended to apply a pro rata

approach. *See e.g. S.E.C v. Forex Asset Management, LLC,* 242 F. 3d 325, 331 (5th Cir. 2001) (district court did not abuse its discretion in approving a pro rata distribution plan even though the party's assets were held by the defrauder in a segregated account); *U.S. v. Durham*, 86 F. 3d 70, 73 (5th Cir. 1996)(although tracing could have been permissible under the circumstances of this case, the court, in exercising its discretionary authority in equity, was not obliged to apply tracing); *U.S. v. Vanguard*, 6 F. 3d 222, 226-28 (4th Cir. 1993) (rejecting tracing argument based on the equitable nature and purpose of a court supervising a federal equity receivership which has the power to deny remedies as inimical to receivership purposes even though those remedies might be warranted under controlling law). *But see Capital Consultants*, 2002 WL 32502450 at * 5-6 (D. Or. 2002) (although a traced asset calculation was dismissed as an option for all investors, the court did permit an exception for those investors that could present written evidence that: (i) they instructed that their investments be invested into specific investments; (ii) their instructions were complied with; and (iii) there was no discretion exercised in actually moving those investors' funds between investments).

Moreover, it has been held that tracing methods should not be utilized under circumstances involving multiple claimants and commingled funds. *See Equity Financial Group LLC*, 2005 U.S. Dist. LEXIS 20001 at * 82; *Real Property Located at 13328 and 13324 State Highway 75 North,* 89 F. 3d at 553-54. *See also Credit Bancorp*, 290 F. 3d at 88-89("Courts have favored pro rata distribution of assets where, as here, the funds of the defrauded victims were commingled and where victims were similarly situated with respect to their relationship to the defrauders"). Thus, since this case involves multiple investors and commingled funds (*see generally* Receiver's 1st Report at p. 7), a pro rata distribution scheme of distribution is the most equitable method. Furthermore, a pro rata distribution method would be appropriate in this case

because, based upon the facts of this case, it would be forensically impossible to trace any particular funds to any particular investors.

d. Partial Distribution Can Be an Appropriate Equitable Remedy

It is within a receivership court's broad discretion to authorize a partial distribution. For example, in the case of *S.E.C. v. Credit Bancorp, Ltd.*, the S.E.C. recommended that the distribution be partial because the receiver had not yet been able to marshal and bring under his control all assets. *See* 2000 WL 1752979 at *27. In that case, the court agreed with the S.E.C. and explained that, "[a]lthough the customers differ greatly as to what they believe to be the appropriate distribution plan, they share the SEC's view that at present the distribution should be partial, leaving open the possibility of additional distributions if and when additional assets become available." *Id.* Due to the fact that this is a complicated receivership that will probably last for at least several years, the Receiver believes it is in the investors' best interest that the Receiver be authorized to make partial distributions to investors as the receivership progresses.

e. Consolidating Multiple Accounts of Single Investors

The transactions of an investor with ownership interests in more than one account, whether or not owned in different capacities, can be consolidated for purposes of determining the amount of distribution. *See Equity Financial Group,* 2005 U.S. Dist. LEXIS 20001 at *88. As the court in *Equity Financial* found, "not to consolidate would permit an investor who uses different investment vehicles and received funds in one account to obtain a disproportionately large distribution when compared to other single account investors." *Id.* For example, if an investor invested by way of an individual retirement account and also invested directly, the withdrawals in one account should be considered in determining the amount of total distribution to the investor. *Id.* Thus, in this case, the transactions of investors who invested in multiple

accounts with the Receivership Entities should be consolidated for purposes of determining the investors' allowed claim amounts.

4. The Treatment of "Profits"

One of the main complications in calculating the amount of an investor's claim is determining how to treat the payments[3] made by the Receivership Entities to the investors (these payments will hereinafter be referred to as "Profits").[4] As demonstrated below, the consequences of choosing one distribution formula over another will have a direct impact on the amounts that will be recovered by each type of investor. Some of the distribution options examined below recognize a claim to investors' "Profits" while others do not. The options that do not recognize a claim to Profits are generally referred to as "net investment" approaches. An examination of the case-law reveals that most courts supervising a federal equity receivership have adopted some sort of "net investment" approach. However, as further discussed below, even among the "net investment" approaches, there is a difference in the formulations of how to treat investors' claims for "Profits".

a. Rationales in Favor of a Net Investment Approach

Much of the rationale in the case-law in support of the use of a "net investment" approach in formulating a distribution plan has been in response to investment schemes in which earlier investors' returns are generated by the influx of fresh capital from newcomers rather than through legitimate investment activity. *See e.g. generally Cabe*, 311 F. Supp. 2d at 509; *Cunningham v. Brown,* 265 U.S. 1, 44 S. Ct. 424, 68 L. Ed. 873 (1924). Thus, although a corporation operates at a loss, that corporation continues to give the appearance of being

[3] These payments from the Receivership Entities to investors may include dividends, interest, profits, commissions, referral fees, or any other type of payment.

[4] These payments will hereinafter be referred to as "Profits" simply for ease of reference and no judgment is being passed as to the true nature and quality of these payments.

profitable by obtaining new investors and using those new investments to pay for the high premiums promised to earlier investors. *See Hirsch v. Arthur Anderson & Co.*, 72 F. 3d 1085, 1088, n. 3 (2d Cir. 1995). The effect of such a scheme is to put the corporation farther and farther into debt by incurring more and more liability and to give the corporation the false appearance of profitability. *Id.* As one court has explained:

> The rationale for a net investment approach is twofold. First, it is in the nature of a Ponzi scheme that customer returns are generated not from legitimate business activity, but, rather, through the influx of resources from new customers. Since all the funds were obtained by fraud, to allow some investors to stand behind the fiction that the Ponzi scheme had legitimately withdrawn money to pay them would be carrying the fiction to a fantastic conclusion....Thus, permitting customers to retain such gains comes at the expense of the other customers. Second, recognizing claims to profits from an illegal financial scheme is contrary to public policy because it serves to legitimate the scheme. (internal citations and quotations omitted).

Credit Bancorp, 2000 WL 1752979 at * 40.

In this case, the rationale in favor of a "net investment" approach is applicable to a certain extent. As was discussed above, although many of the investments made by Worldwide and TEGFI were profitable, many other ventures also proved unprofitable and, over the years, Worldwide and TEGFI lost millions of dollars. *See* Receiver's 1st Report at p. 6. In fact, the Receiver can point to many individual investments that were unprofitable yet the Receivership Entities made "Profit" distributions to investors with respect to such unprofitable investments. Accordingly, at least with respect to these specific investments, Worldwide and TEGFI paid Profit to investors in connection with these specific investments in part from other investors' money. Moreover, in the aggregate, it does not appear at this stage of the Receiver's inquiry that Worldwide and TEGFI, generated sufficient, if any, profit at all times and as a whole to support the return of principal, interest and/or "Profits" that were paid to the investors. *Id.* Yet,

Worldwide and TEGFI continued to honor investors' notes and it seems that "Profit" paid to investors came in part from other investors' money. *Id.*

Thus, at some point in time, the Receivership Entities utilized new investors' funds in part to pay returns to older investors, and for this reason, some sort of "net investment" approach would seem to be an appropriate distribution plan in this case. However, the adoption of a "net investment" approach that totally disregards the investors' "Profits" may be deemed to be inappropriate in this case because of the fact that the task of determining precisely when the Receivership Entities started paying investor returns from money raised from new investors will be difficult, if not impossible, and since it is believed that the Receivership Entities also, at some point in time, may have operated profitable businesses. As a result, the Receiver is hereby requesting guidance from this Court as to how to treat investors' "Profits" and, in this regard, has set forth the opinions of other courts regarding the various options of how to treat investors' claims to "Profits".

Generally, "net investment" options have been deemed to be a more "equitable" approach to treating investors' claim to "Profits". *See e.g. Capital Consultants*, 2002 WL 32502450 at * 2; *C.F.T.C. v. Franklin,* 652 F. Supp. 163, 169 (W.D. Va. 1986) *rev'd on other grounds Anderson v. Stephens,* 875 F. 2d 76 (4th Cir. 1989)[5]. For example, in support of a net investment approach, the court in *Capital Consultants* explained that one reason why a net investment approach was preferred was the belief that where individuals have been similarly defrauded, all should recover their principal before any recovers profits or interest. *See Capital Consultants*, 2002 WL 32502450 at * 2. In addition, in *Capital Consultants*, the court explained that the vast majority of investors in that case invested under extremely broad investment guidelines and the degree of

[5] As recognized by the 11th Circuit Court in *Elliott,* 953 F. 2d at 1570, the Fourth Circuit's opinion in *Anderson* was narrow and did not reach the *Franklin* court's analysis of the equitable nature of a receivership's distribution plan which is relevant here.

success achieved by any particular investor was a matter of chance rather than control or diligence. *Id.* Certain investors in that case with long standing accounts objected to adopting a net investment formula, arguing that such an approach ignored the time value of money, which can be significant with the older and larger accounts. *Id.* The receiver in *Capital Consultants* explained that this consideration was balanced by the fact that no adjustment was made for money paid out years ago which could have been reinvested elsewhere and earning a return. *Id.* Moreover, the court recognized that although the investors that have previously withdrawn amounts greater than their initial investment from their investment accounts will receive no distribution under the net investment approach, at least those investors have gotten their principal returned. *Id.* As the court in *Capital Consultants* observed, "[a]lthough they have not received the benefit of their bargain in the nature of promised returns, they are in a better situation than others who will not recover their principal." *Id.*

In the case of *Equity Financial Group*, the court determined that investors' claims would be recognized only for actual dollar amounts invested and rejected any claims for profits, interest or other earnings shown on investors' account statements because the court found that recognizing "profits" or other earnings in claims for distribution would be to the detriment of later investors and would therefore be inequitable. *Equity Financial Group*, 2005 U.S. Dist. LEXIS 20001 at * 76-77. In reaching this conclusion, the court in *Equity Financial Group* accepted the receiver's assertion that relatively large gains were reported to investors even though the economic activities of the company actually resulted in large losses. *Id.* Thus, the receiver in that case argued that to recognize "gains" of investors would cause recent investors (whose accounts would have supposedly accrued little or no profits) to give up a share of the money they actually invested in order to fund a return of fictitious profits to earlier investors

(whose accounts would have supposedly accrued relatively large profits). *Id.* Thus, the court in *Equity Financial Group* found that it would be inequitable to allow recovery of both "Profits" and the original investment because otherwise a claimant's original investment would be repaid at the expense of equally innocent later investors. *Id.* In this way, no investor would receive the benefit of his bargain, but all would share some recovery. *Id. See also generally In Re Old Naples Securities,* 311 B.R. 607, 617 (M.D. Fla. 2002)("permitting claimants to recover not only their initial capital investment but also the phony 'interest' payments they received and rolled into another transaction is illogical...[otherwise] the fund would likely end up paying out more money than was invested in [the] Ponzi scheme"); *Hoffberg*, 1993 WL 441984 at *3 (adopting net investment approach in recognition of fact that the "profits" paid out to certain investors were actually part of the res so that allowing those investors an additional recovery would come at the expense of other investors).

b. Examination of Possible Options for the Treatment of "Profits"

Four possible options for the treatment of the "Profits" investors may have received or accumulated have been described in the relevant case-law as follows and are further examined below[6]: (1) recognize "Profits" as part of the investors' claims but investors would be required to return all "Profits" previously withdrawn to the estate (this option is hereinafter referred to as "Option 1"); (2) recognize "Profits" as a part of an investor's claim and investors could retain "Profits" previously withdrawn and still claim a proportionate share based on the amount invested (this option is hereinafter referred to as "Option 2"); (3) disregard "Profits" as a part of a claim but investors could retain "Profits" already withdrawn although this amount will be

[6] While there are a myriad of possible approaches that may be suggested in devising a distribution plan, these four general categories of methods are the ones discussed in the relevant equity receivership case-law gathered by the Receiver. Other methods may have been mentioned in passing in the case law, but were cursorily dismissed with little or no discussion by the courts. For instance, in *Equity Financial Group,* the court rejected a "fist in-first out" approach. *Equity Financial Group*, 2005 U.S. Dist. LEXIS 20001 at * 18-19.

subtracted from their proportionate share calculated with regard to their total investment, i.e. subtract withdrawn "Profits" after determining the pro rata share of their investments (this option is hereinafter referred to as "Option 3"); or (4) disregard "Profits" as a part of a claim but investors could retain their "Profits" already withdrawn although this amount will be subtracted from their total investment in calculating their proportionate share, i.e. subtract "Profits" before determining the investor's pro rata shares (this option is hereinafter referred to as "Option 4"). *See Equity Financial Group,* 2005 U.S. Dist. LEXIS 20001; *C.F.T.C v. Skorupskas*, 1988 U.S. Dist. LEXIS 18649 at *4-5; *Franklin,* 652 F. Supp. at 169.

Option 3 and Option 4 are both "net investment" approaches which disregard investors' claims to "Profits" and, for the reasons set forth in the section above, it is more likely that Option 3 or Option 4 will be considered to be the more equitable options. Nonetheless, Option 1 and 2 are discussed below so as to demonstrate the inequitable nature of those options. Lastly, a hybrid option is also mentioned below as an attempt to address the concern that the facts of this case may be slightly different than the typical full blown "Ponzi"-scheme cases which are generally at issue in the cited case-law.

i) Option 1: Recognize "Profits" but Investors Must Return Withdrawn "Profits" to Estate

Option 1 would recognize "Profits" as part of an investor's claim but "Profits", if withdrawn, must be repaid into the receivership and then redistributed through the distribution process. This option has been rejected by those courts which considered this option. *See e.g. Equity Financial Group*, 2005 U.S. Dist. LEXIS 20001 at * 84-85 (this option is not a cost-effective method and would also raise issues of collectability); *Skorupskas*, 1988 U.S. Dist. LEXIS 18649 at *5. As recognized by the court in *Franklin,* 652 F. Supp at 169, this option is impracticable because it unrealistically would require some investors to return funds that they

may no longer have on hand. Moreover, Option 1 may not be equitable for the reasons discussed above regarding the rationales in favor a net investment approach. The Receiver has been unable to find any case which has approved and utilized this option.

ii) Option 2: Recognize "Profits" and Investors Could Retain "Profits" and Still Claim a Proportionate Share

Option 2 essentially proposes to include accumulated "Profits" as reflected on an investor's statement and permit investors to retain any "Profits" previously withdrawn, and still claim a proportionate share based on the amount invested. Option 2 may not be equitable for the reasons discussed in the section regarding the rationales in favor a net investment approach.

Moreover, Option 2 has also been rejected as an equitable distribution option by those courts that have considered it. *See e.g. Equity Financial Group,* 2005 U.S. Dist. LEXIS 20001 at * 83-5; *Skorupskas*, 1988 U.S. Dist. LEXIS 18649 at *5. As observed by one court, to ignore the withdrawals and include claims for accumulated "Profits" of the investors would be "inequitable because it rewards some investors for their random good fortune while depleting the shares available to investors who were equally situated but merely less lucky." *Franklin,* 652 F. Supp. at 169. Moreover, it has been reasoned that it is equitable that where individuals have been similarly defrauded, all should recover their principal before any recovers profits or interest. *See Capital Consultants*, 2002 WL 32502450 at * 2.

One argument in favor of Option 2 that has been offered by certain investors in the *Credit Bancorp* case, but ultimately rejected by that court, is that any net investment approach which reduces a claim by the amount of "Profits" received from the corporation would unfairly penalize the "older" victims, i.e., those who entered the program at an earlier time. *See Credit Bancorp*, 2000 WL 1752979 at * 40. Those investors also argued that it was unfair to not recognize "Profits" because the older investors have already paid income taxes on the monies they received

from the corporation. *Id.* Nonetheless, the court in *Credit Bancorp* rejected those arguments and responded that "it is also the case that those investors have enjoyed the opportunity to make use of those monies as they saw fit and, indeed, have benefited from the time value of money." *Id.* at 41. Further, the court found that, although an approach that would not recognize "Profits" may affect different investors differently, it does not have an unfair or disproportionate impact on older investors and that, on the contrary, since these payments should be properly deemed as coming out of the estate, then allowing them to be retained free and clear would be at the expense of other investors. *Id.* The Receiver has been unable to find any case which has approved and utilized this option.

iii) Option 3: Previously Withdrawn "Profits" Are Subtracted AFTER Determining the Investors' Pro Rata Share

Option 3 proposes to generally disregard investors' claims for "Profits" that have accumulated in their investment accounts. Option 3 also provides that investors can retain "Profits" already withdrawn but have this amount subtracted AFTER determining their pro rata share. In other words, Option 3 is represented by the following formula: (Investor's Actual Dollars Invested *divided by* Aggregate Actual Amount Invested by All Investors) *multiplied by* (Amount Available for Distribution) *minus* (Profits Previously Received).

This method for treating withdrawn investor "Profits" was adopted in the case of *Equity Financial Group* and was referred to by that court as the "rising tide" method. *Equity Financial Group* 2005 U.S. Dist. LEXIS 20001 at * 83 (investors are permitted to retain previously received funds, but those withdrawals will be credited against the investors' respective pro rata shares calculated according to the following formula: (actual dollars invested x pro rata multiplier) minus any "Profits" = distribution amount.) Thus, only investors who have received less in withdrawals than their respective distribution amount will receive funds. *Id.* Any

investor whose withdrawals were in excess of their distribution amounts would not receive any distribution in the interim distribution plan. *Id.* The court in *Equity Financial Group* found the "rising tide method" to be the most equitable because, under this method, there will be more funds available to the investors with allowable claims, and also because this method does not penalize investors based on the timing of their investments. *Id.*

Likewise, in *Hoffberg,* the plan adopted by the court provided for a distribution according to the following formula: (Initial Investment x pro rata %) – amounts received by investors as "Profits". *Hoffberg,* 1993 WL 441984 at * 2. The result of this formula was that investors who had withdrawn, or otherwise received back, more than the pro rata percentage of their initial investment would not recover additional amounts from the court's distribution. *Id.* As the *Hoffberg* court explained, even though Option 4 may, at first blush, seem preferable to Option 3 because Option 4 would allow more investors to have some money at distribution, however, Option 4 overlooks the fact that there is a fixed amount of money available for distribution and that, therefore, the pro rata % multiplier would have to be reduced. *Id.* Although the *Hoffberg* court recognized that both Option 3 and Option 4 have support in the case law, the *Hoffberg* court considered Option 3 to be more "equitable". *Id. See also Cabe*, 311 F. Supp. 2d at 509 (persons who have been previously repaid by the defendants should receive a reduced amount so that the total amount they receive both for the receivership distribution and from the earlier repayment from the defendants would roughly equal the amount they would have received from a pro rata distribution had they not received any money during the scheme from the defendants); *Skorupskas*, 1988 U.S. Dist. LEXIS at *6 (the court favored Option 3 and rejected Option 4).

iv) Option 4: "Profits" Previously Withdrawn Are Subtracted BEFORE Determining the Investors' Pro Rata Shares

Like Option 3, Option 4 proposes to generally disregard investors' claims for "Profits" that have accumulated in their investment accounts. However, Option 4 proposes that investors could retain "Profits" already withdrawn but have this amount subtracted BEFORE determining their pro rata share. In other words, Option 4 is represented by the following formula: ((Investor's Actual Dollars Invested *minus* Profits Previously Received) *divided by* Aggregate Actual Amount Invested by All Investors) *multiplied by* (Amount Available for Distribution).

One case which adopted a version of the Option 4 methodology was *Capital Consultants*, 397 F. 3d at 737. In that case, the distribution formula was called a "money-in-money-out" (or "MIMO") formula and, under this formula, the investor's net loss was measured by the total amount invested by the client ("Money-In") minus the total amount returned to the investor before the receivership, ("Money-Out"). *Id.* In addition, to the extent the investor obtained any third party recovery, then 50% of those amounts would also be treated as "Money-Out" and deducted from the total "Money-In". *Id.* at fn 5. Each investor would receive its pro rata share (computed by that investor's loss to total loss of all investors) of its net loss. *Id.* at 737. *See also Cabe,* 311 F. Supp. 2d at 509-510.

Similarly, the court in *Franklin* adopted Option 4. *Franklin*, 652 F. Supp. at 170. The *Franklin* court found that subtracting "Profits" from the initial investment before determining an investor's pro rata share more accurately treated the fake "profits" as merely redistributed capital. *Id.* However, the *Franklin* opinion and Option 4 have been criticized by other courts. For example, the *Skorupskas* court found the reasoning of the *Franklin* opinion to be "somewhat opaque". *Skorupskas*, 1988 U.S. Dist. LEXIS at * 6-7. The *Skorupskas* court favored Option 3 and rejected Option 4 because it reasoned that since any "Profits" were actually part of the res,

then Option 4 would permit those investors who insisted on cashing out their "Profits" to receive more from the res than their proportionate share based on their total investment and thereby, in effect, permitted those investors to defeat the pro rata scheme of distribution. *Id. See also Equity Financial Group,* 2005 U.S. Dist. LEXIS 20001 at *85 ("[T]he net investment theory which would require the Court to subtract any withdrawals from an investor's total cash investment prior to calculating each investor's pro rata share, would result in certain investors receiving back more than such investor's proportionate share of investments"). In addition, the court in *Hoffberg* explained as follows:

> [W]e note that the court in *Franklin* was operating under an incorrect assumption: that investors who had not previously received money would receive the same return under either of the formulas. *See Franklin,* 652 F. 2d at 170...[T]hat assumption is incorrect because the pot of money to be divided is a fixed amount. If more people are to receive money from it, as provided by the second formula [i.e. "Option 4"] investors who had not previously received money will receive less than they would under the first formula [i.e. "Option 3"].

Hoffberg, 1993 WL 441984 at *3.

v) Hybrid Option: A Net Investment Approach Coupled With a Reasonable Interest Rate

As discussed above, a receivership court has wide discretion to formulate any plan that it deems equitable to accomplish a fair distribution to the investors. *See generally S.E.C v. Elliott,* 953 F. 2d at 1566. As such, this Court may adopt one of the methods discussed above that have been used by other courts involved with federal equity receiverships. Alternatively, this Court may fashion its own hybrid or compromise formula in order to accomplish an equitable distribution. For example, in *Credit Bancorp*, the court adopted a "compromise" formula where an investor could choose to retain their security investments if they paid an "undertaking" fee into the receivership equal to a percentage of the market value of the security. *See Credit Bancorp*, 2000 WL 1752979 at * 29

In this case, one possible hybrid distribution method could combine one of the net investment formulas discussed above (i.e. either Option 3 or Option 4) with an interest payment to the investors based on a fair, but yet-to-be-determined, market interest rate. Such a distribution method would recognize the time value of the money to the benefit of those investors who entered the program at an earlier time. In addition, this hybrid method would also provide some sort of recognition that this case might differ slightly from the typical federal equity receivership cases. As discussed above, part of the rationale for disregarding the "Profits" or other earnings given to an investor of an entity that committed a fraudulent Ponzi scheme involve the fraudulent nature of the scheme. *See generally Equity Financial Group*, 2005 U.S. Dist. LEXIS 20001 at * 76-77; *Credit Bancorp*, 2000 WL 1752979 at * 40. Yet, unlike the typical case, in this case, it seems that the Receivership Entities may have, at one time, been profitable and distributing legitimate Profits to earlier investors. However, in the present case, it is unclear and, based upon the poor records available, it seems to be unfeasible at this time, to determine at what point in time the Receivership Entities became unprofitable. *See generally Capital Consultants*, 2002 WL 32502450 at * 2 (under certain circumstances, the administrative costs of taking calculations back to the inception of the investments are not worth whatever benefit would result). This case is unlike the case of *Capital Consultants* in which the court was able to determine the exact date when the "Ponzi-like" aspects of the investment program began and, accordingly, was able to use that date as the determining date for evaluating the value of a claim. *See Capital Consultants*, 2002 WL 32502450 at * 2. Thus, the interest calculation included in this hybrid method, could compensate, at least to some degree, for the inaccuracies of determining when the Receivership Entities actually began to be unprofitable and started utilizing new investors' funds to in part pay "Profits" to older investors.

However, one negative of this hybrid method would be that, since the pool of funds to be distributed is fixed, then adding interest to each claim would necessarily reduce the amounts otherwise to be received by the more recently invested investors in favor of the "older" investors. This implication may raise concerns about the equitability of this sort of plan. In addition, the accounting of this sort of approach may be extremely complicated, costly and overly burdensome to the Receiver since, as a result of investors' roll-overs and the Receivership Entities' poor record-keeping, it may be difficult to discern the amounts of initial investment each investor actually had invested in the Receivership Entities for each year and to thereby credit the appropriate amount of interest to each investor.

c. Receiver's Recommendation for the Treatment of "Profits"

Based on the foregoing, the Receiver would recommend the adoption of either net investment approach discussed above. Although there is support in the case-law for either Option 3 or Option 4, the Receiver recognizes that the methodology of Option 3 would achieve the most parity in the distributions to the investors. Thus, although the administrative expenses may be higher with the implementation of Option 3, the Court may wish the Receiver to utilize Option 3. In addition, should this Court see fit to compensate the investors to some degree for the time value of their investments and for any inaccuracies in determining the date which the "Ponzi"-like characteristics began, then the Receiver further believes that the adoption of a hybrid method combining an interest payment with either net investment distribution method would also be equitable.

B. Examples of How Each Option Discussed Above Would Impact Hypothetical Investors

In order to demonstrate the options discussed above as to how to determine an investor's pro rata share of distribution, the following section contains hypothetical examples demonstrating how each of those options would impact certain classes of hypothetical investors.[7]

1. The Hypothetical Investors

As is the case with the investors in this receivership, the hypothetical investors described below were intended to portray a range of investor types including those investors that have been invested for many years, investors that have more recently invested, investors that have cashed-out the "Profits" in their investment accounts and those other investors that may have rolled-over "Profits" and left them in their investment account. The classes of hypothetical investors are categorized as follows:

- **"Investor A"**: Investor A has had $100,000 invested with the Receivership Entities for four years. She has pulled out $20,000 per year as "Profits". Thus, Investor A has received $80,000 from the Receivership Entities ($20,000 per year for four years) and still has a balance of $100,000 reflected on her statement with the Receivership Entities.
- **"Investor B":** Investor B has had $100,000 invested with the Receivership Entities for four years. Investor B chose to "rollover" his $20,000 per year of "Profits" to accumulate in his account. Thus, Investor B has received no money from the Receivership Entities and the balance in his account is reflected as $180,000 (the $100,000 initial investment plus the $80,000 in accumulated "Profits").

[7] The figures that are being used in these examples are purely hypothetical and were chosen solely for simplicity and comparison sake and are not reflective of every possible scenario.

- **"Investor C":** Investor C invested $100,000 with the Receivership Entities on the eve of receivership. He has not had the opportunity to earn any Profits on his investment and has a balance of $100,000 reflected on his statement with the Receivership Entities.
- **"Investor D":** Investor D has had $100,000 invested with the Receivership Entities for twelve years. He has pulled out $20,000 per year as "Profits". Thus, Investor D has received $240,000 from the Receivership Entities ($20,000 per year for twelve years) and still has a balance of $100,000 reflected on his statement with the Receivership Entities.

Summary of the Characteristics of the Hypothetical Investor:

	Investor A	Investor B	Investor C	Investor D
Initial Investment	$100,000	$100,000	$100,000	$100,000
Years Invested	4	4	0	12
Amount of "Profits" Withdrawn	$80,000	$0	$0	$240,000
Statement Balance	$100,000	$180,000	$100,000	$100,000

2. Examples of How Each Option Impacts Each Class of Hypothetical Investor

The following is a demonstration of how the four options discussed above would affect each class of hypothetical investor described above. The examples below assume that a pro rata distribution method, as opposed to a traced asset calculation, is adopted to determine the claims of the investors. The examples below also assume that the value of the fixed pool of assets available to be distributed to satisfy the hypothetical investors' claims is $200,000.[8]

[8] This amount is purely hypothetical and was chosen solely for simplicity and comparison sake.

Option 1:

Option 1 would recognize "Profits" on investors' statements as a part of their claim but would require that all "Profits" be returned to the receivership estate and then redistributed to each investor based on his or her pro rata share. Thus, Investor A would be required to return $80,000 to the estate and then have a claim for $180,000. Investor B would be required to return $0 to the estate and have a claim for $180,000. Investor C would be required to return $0 to the estate and have a claim for $100,000. Investor D would be required to return $240,000 and have a claim for $340,000. The total amount of claims of Investors A, B, C and D combined would be $800,000.00. Accordingly, each hypothetical investor's pro rata share of the distribution would be as follows:

-- Investor A's pro rata share would be $180,000 / $800,000 or 22.5%.

-- Investor B's pro rata share would be $180,000 / $800,000 or 22.5%.

-- Investor C's pro rata share would be $100,000 / $800,000 or 12.5%.

-- Investor D's pro rata share would be $340,000 / $800,000 or 42.5%.

Since the available funds would hypothetically be $520,000[9], then each hypothetical investor would recover as follows:

-- Investor A would receive distribution of approximately $117,000 (or 22.5% of $520,000) which would be 117% of her initial investment.

--Investor B would receive distribution of approximately $117,000 (or 22.5% of $520,000) which would be 117% of his initial investment.

-- Investor C would receive distribution of approximately $65,000 (or 12.5% of $520,000) which would be 65% of his initial investment.

[9] The $200,000 available for distribution is increased by the Profit returned by Investors A and D.

-- Investor D would receive distribution of approximately $221,000 (or 42.5% of $520,000) which would be 221% of his initial investment.

As this example demonstrates, Option 1 does not result in an equitable distribution scheme because even though each hypothetical investor originally invested $100,000, the investors that were invested the longest, such as Investor D, would recover far more at the expense of the "newer" investors such as Investors A, B and C (not taking into account the time value of money). Moreover, as previously stated, in reality issues such as collectibility and cooperation make this option impracticable and unworkable.

Option 2:

Option 2 would permit investors to retain all "Profits" and include any accumulated "Profits" as a part of their claims. Thus, Investor A would be permitted to retain the $80,000 of "Profits" pulled out previously and then have a claim for $100,000 as reflected on her account statement. Investor B would have a claim for $180,000 ($100,000 original investment plus the $80,000 of accumulated "Profits") as reflected on his account statement. Investor C would have a claim for $100,000 as reflected on his account statement. Investor D would be permitted to retain the $240,000 of "Profits" previously withdrawn and still have a claim for the $100,000 as reflected on his account statement. Thus, the total amount of claims of Investors A, B, C and D as reflected on their account statements would be $480,000. Accordingly, pursuant to Option 2, the pro rata share of distribution for each hypothetical investor would be as follows:

-- Investor A's pro rata share would be $100,000 / $480,000 or 22.8%.

-- Investor B's pro rata share would be $180,000 / $480,000 or 37.5%.

-- Investor C's pro rata share would be $100,000 / $480,000 or 22.8%.

-- Investor D's pro rata share would be $100,000 / $480,000 or 22.8%.

Since the value of the available hypothetical funds would be $200,000, then, pursuant to Option 2, each hypothetical investor would recover as follows:

-- Investor A would receive a distribution of approximately $45,600 (or 22.8% of $200,000) plus the $80,000 previously withdrawn which would be equivalent to 125.6% of her initial investment.

-- Investor B would receive a distribution of approximately $75,000 (or 37.5% of $200,000) which would be 75% of his initial investment.

-- Investor C would receive distribution of approximately $45,600 (or 22.8% of $200,000) which would be the equivalent of 45.6% of his initial investment.

-- Investor D would receive distribution of approximately $45,600 (or 22.8% of $200,000) plus the $240,000 which was previously withdrawn which would be equivalent to 285.6% of his initial investment.

Like Option 1, Option 2 also significantly favors the "older" investors, such as Investor D, over the "newer" investors and accordingly may also be considered an inequitable distribution scheme.

Option 3:

Option 3 proposes that "Profits" accumulated as shown on the investor's statements are disregarded but that investors could retain "Profits" previously withdrawn but have this amount subtracted after determining their pro rata share. In determining the pro-rata share, the claim of any investor who received more back in Profits than invested would be disregarded, thus, Investor D would only participate in the distribution in the unlikely event all other investors receive back their entire investment.

The amounts used to determine the pro rata multiplier under this method would be the initial investment of the hypothetical investors which would be $100,000 for each of Investors A, B and C (not D) for a total of $300,000. Since each investor's claim is $100,000 of the $300,000 in claims, each investor's pro rata claim is one-third, or 33%, of the total claim. Pursuant to Option 3, the amounts previously received by the hypothetical investor would then be subtracted from the amount to be received from the distribution. Thus, pursuant to Option 3, the calculation to determine what each investor will receive is as follows:

(First Level)

-- Investor A will receive $0 from the first level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($200,000 Amount Available for Distribution) *minus* ($80,000 Profits Previously Received). Since the result of this equation is negative, $0 is credited to Investor A at this time.

-- Investor B would receive $66,666, from the first level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($200,000 Amount Available for Distribution) *minus* ($0 Profits Previously Received).

-- Investor C would receive $66,666 from the first level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by*

($200,000 Amount Available for Distribution) *minus* ($0 Profits Previously Received)

Thus, after the first level of calculations, according to the methodology of Option 3, the hypothetical investors received $133,332 of the total available asset pool of $200,000 and the remaining $66,668 also needs to be allocated:

(2nd level)

-- Investor A would receive $8,866 from the second level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($66,668 Amount Available for Distribution) *minus* ($13,334)[10]

-- Investor B would receive $22,200 from the second level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($66,668 Amount Available for Distribution) *minus* ($0 Profits Previously Received)

-- Investor C would receive $22,200 from the second level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $400,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($66,668 Amount Available for Distribution) *minus* ($0 Profits Previously Received)

Thus, in the second level of this calculation, according to the methodology of Option 3, the hypothetical investors received $53,266 of the total available asset pool of $66,668 and the

[10] (80,000 originally received minus $66,666 credited to investors B and C in first level).

remaining $13,402 would be distributed pro rata based on the same formula, as follows, until the remaining funds are distributed:

(3rd level)

-- Investor A would receive $4,467 from the third level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($13,402 Amount Available for Distribution) *minus* ($0 Remaining Excess Profits)[11]

-- Investor B would receive $4,467 from the third level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $400,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($13,402 Amount Available for Distribution) *minus* ($0 Profits Previously Received)

-- Investor C would receive $4,467 from the third level calculation based on the following equation: ($100,000 Investor's Actual Dollars Invested *divided by* $300,000 Aggregate Actual Amount Invested by All Investors) *multiplied by* ($13,402 Amount Available for Distribution) *minus* ($0 Profits Previously Received)

Ultimately, the hypothetical investors would recover in the initial distribution as follows under Option 3:

[11] Investors who did not participate in a round of distributions would have to receive credit in the amount of the distribution they did not receive.

-- Investor A would receive $13,333 in initial distributions plus the $80,000 previously withdrawn "Profits" for a total recovery of $93,333 which is the equivalent of 93.33% of her initial investment.

-- Investor B would receive the $93,333 initial distribution which is 93.33% of his initial investment.

-- Investor C would receive the $93,333 initial distribution which is 93.33% of his initial investment.

-- Investor D would not share in any portion of the distribution and would not share in any future distributions unless the unlikely event occurs that all investors recoup their entire investment.

As this example demonstrates, the application of Option 3 results in the least disparity between the amounts the investors ultimately recover, however, the cost of going through the calculations required to reach parity will certainly be greater than any other method, although not cost prohibitive.

Option 4

Option 4 proposes that "Profits" accumulated as shown on the investors' statements are disregarded and that investors can retain "Profits" previously withdrawn as long as this amount is subtracted from their total initial investment in calculating their proportionate share [i.e. (initial investment minus amounts received by investors as "Profits") x pro rata %].

Thus, the hypothetical investors would be permitted the following claims in determining their pro rata share of distribution as determined by their initial investment minus amounts received by investors as "Profits":

-- Investor A would have a claim based on her initial investment of $100,000 minus the $80,000 she previously withdrew thereby resulting in a claim for $20,000.

-- Investor B would have a claim based on his initial investment of $100,000 and, since he never withdrew any "Profits" previously, his claim would be $100,000.

-- Investor C would have a claim based on his initial investment of $100,000 minus the $200,000 he previously withdrew as "Profits" thereby resulting in a claim for $100,000.

-- Investor D would have a claim based on his initial investment of $100,000, however since he previously withdrew $120,000 which is more than the amount he initially invested, Investor D would have a claim for $0.

The total amount of claims for the hypothetical investors combined would be $220,000 (i.e. Investor A's $20,000 claim plus Investor B's $100,000 claim plus Investor C's $100,000 claim plus Investor D's $0 claim.) Accordingly, the pro rata share for each hypothetical investor is as follows:

-- Investor A's pro rata share of the claim would be $20,000/ $220,000 or a 9% pro rata share of the total claims.

-- Investor B's pro rata share of the claim would be $100,000/ $220,000 or a 45.5% pro rata share of the total claims.

-- Investor C's pro rata share of the claim would be $100,000/ $220,000 or a 45.5% pro rata share of the total claims.

-- Investor D would receive nothing in this distribution.

Thus, the hypothetical investors would ultimately receive the following distribution of the hypothetical $200,000 asset pool based on Option 4:

-- Investor A would receive $18,000 from the distribution (*i.e.* 9% of $200,000) plus the $80,000 she previously withdrew from her account and thus she has received a total of $98,000 returned from her initial investment of $100,000 which is the equivalent of 98% of her initial investment.

-- Investor B would receive $91,000 from the distribution (*i.e.* 45.5% of $200,000) but since he previously withdrew nothing from his account, he has received a total of $91,000 returned from his initial investment of $100,000 which is the equivalent of 91% of his initial investment.

-- Investor C would receive $91,000 from the distribution (*i.e.* 45.5% of $200,000) plus the $0 he previously withdrew from his account and thus he has received a total of $91,000 returned from his initial investment of $100,000 which is the equivalent of 91% of his initial investment.

--Investor D would receive nothing from this distribution since he already has had a return of more than 100% of his initial investment.

As this example demonstrates, Option 4 also results in a substantially equitable distribution, although not as accurate as Option 3 as the results of this Option slightly favor the "older" investor who actually withdrew his or her accumulated "Profits". Moreover, the accounting costs required under Option 4 is less than Option 3.

The following is a chart which summarizes the results of the hypothetical examples set forth above and which demonstrates that Option 3 and 4 are the most equitable distribution schemes.

Summary of the Amounts Received by the Hypothetical Investors Pursuant to the Distribution Options:

	Investor A	Investor B	Investor C	Investor D[12]
Option 1	Receives **117%** of initial investment ($117,000 distribution amount)	Receives **117%** of initial investment ($117,000 distribution amount)	Receives **65%** of initial investment ($65,000 distribution amount)	Receives **221%** of initial investment ($221,000 distribution amount)
Option 2	Receives **125.6%** of initial investment ($45,600 distribution amount plus $80,000 previously withdrawn "Profits")	Receives **75%** of initial investment ($75,000 distribution amount plus $0 previously withdrawn "Profits")	Receives **45.6%** of initial investment ($45,600 distribution amount plus $0 previously withdrawn "Profits")	Receives **285.6%** of initial investment ($45,600 distribution amount plus $240,000 previously withdrawn "Profit")
Option 3	Receives **93.33%** of initial investment ($13,333 distribution amount plus $80,000 previously withdrawn "Profits")	Receives **93.33%** of initial investment ($93,333 distribution amount plus $0 previously withdrawn "Profits")	Receives **93.33%** of initial investment ($93,333 distribution amount plus $0 previously withdrawn "Profits")	Receives **240**% of initial investment ($0 distribution amount plus $240,000 previously withdrawn "Profits")
Option 4	Receives **98%** of initial investment ($18,000 distribution amount plus $80,000 previously withdrawn "Profits")	Receives **91%** of initial investment ($91,000 distribution amount plus $0 previously withdrawn "Profits")	Receives **91%** of initial investment ($91,000 distribution amount plus $0 previously withdrawn "Profits")	Receives **240%** of initial investment ($0 distribution amount plus $240,000 previously withdrawn "Profits")

[12] It is important to note that the Receiver can seek return of the excess profits Investor D received pursuant to applicable fraudulent transfer case law which will further even out the recovery among investors.

Hybrid Option

Under this option, the Court could seek to recognize the time value of money or "opportunity costs" by seeking to give investors credit for the time they were involved with the Receivership Entities by applying a yet to be determined "market" interest rate in computing claim amounts. In preliminary research, the Receiver has determined that from 1998 to the end of 2005, the S&P index grew at an average rate of 4.75% per year and Treasury bills earned an average of approximately 3.84% per year.[13] Thus, the Receiver believes an imputed market return of approximately 4% to 5% is reasonable in the event the Court directs the Receiver to utilize the Hybrid approach.

IV. CONCLUSION

Since the development of an equitable distribution plan in this federal equity receivership case is a matter of wide discretion, complexity and of great importance to the investors of this case, the Receiver is hereby seeking guidance from the Court as to the formulation of an appropriate distribution plan. Although the facts of this case are slightly different than the typical cases involving federal equity receiverships, the principles and methods addressed in the case-law may provide some guidance to this Court. Ultimately, this Court has broad powers and wide discretion to formulate any distribution plan it deems equitable as long as such plan is not in violation of the investors' due process rights of notice and an opportunity to be heard. An "equitable" plan should aim to treat similarly situated investors alike, even though the outcome may not please all investors. A pro-rata distribution plan, as opposed to a traced asset

[13] The Receiver has chosen to go back as far as 1998 as that is the approximate date from which the majority of funds were invested in Worldwide. These figures were listed in www.moneychimp.com/features/market_cagr.htm and listed at http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histret.html. The Receiver is mindful that other sources may list different data and the years chosen may substantially impact the data. However, the Receiver believes these figures to be accurate and reasonable under the circumstances and is simply using them herein for illustration purposes.

calculation, has been determined to be the most equitable method in cases, such as this one, in which there are multiple victims and commingled funds. In addition, some sort of "net investment" approach, whereby investors' "Profits" are disregarded as a part of the investors' allowable claims, should be adopted in cases, such as this one, in which at least some of the investors' "Profits" are really generated in part from the capital of newer investors. A "net investment" approach may also be considered equitable because it seeks to recover all investors' initial principal payments before any investor recovers "Profits". However, since more than one "net investment" formula has been adopted by other courts in developing distribution plans, the Receiver is seeking guidance from this Court as to which, if any, "net investment" formula the Court would deem most equitable in this case. In light of the foregoing case-law analysis and hypothetical examples as presented in this Memorandum, the Receiver would recommend that either of the "net investment" approaches referred to above as "Option 3" or "Option 4" be adopted. In particular, the Receiver believes that "Option 3" would achieve the most parity in the distributions to the investors and is therefore the most equitable, although it may be more costly. Alternatively, this Court may formulate its own hybrid or compromise distribution formula, such as combining a yet to be determined "market" interest credit with either "net investment" approach, if this Court deems such a plan to be a more equitable method of distributing the receivership assets to the investors.

WHEREFORE, the Receiver respectfully requests this Court enter an Order: (a) establishing a claims procedure to be employed in this case; (b) establishing a claims bar date for this case; (c) authorizing the Receiver to make an interim distribution to investors with allowed claims; and (d) granting such other and further relief as the Court deems just and proper.

LOCAL RULE 7.1 CERTIFICATION OF COUNSEL

Pursuant to Local Rule 7.1, undersigned counsel hereby certifies that he conferred with counsel for the United States Securities and Exchange Commission, the Yeagers and Utsick, none of whom have any objection to the relief requested herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was furnished by U.S. mail this 21st day of September, 2006 to all persons on the attached Service List.

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