UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, **Plaintiff,** **v.** **PLATINUM MANAGEMENT (NY) LLC, d/b/a PLATINUM PARTNERS;** **PLATINUM CREDIT MANAGEMENT, L.P.;** **MARK NORDLICHT;** **DAVID LEVY;** **DANIEL SMALL;** **URI LANDESMAN;** **JOSEPH MANN;** **JOSEPH SANFILIPPO; and** **JEFFREY SHULSE;** **Defendants.**	**Civil Case No. 16-6848(DLI)(VMS)**

SECURITIES AND EXCHANGE COMMISSION'S REPLY IN FURTHER SUPPORT OF ITS APPLICATION FOR ENTRY OF A SECOND AMENDED ORDER APPOINTING RECEIVER AND APPOINTMENT OF A SUBSTITUTE RECEIVER

The Securities and Exchange Commission ("SEC") submits this Reply in Further Support of its Application for Entry of a Second Amended Order Appointing Receiver and Appointment of a Substitute Receiver ("Motion") in response to objections raised by defendants and various creditors and investors (the "Objectors").[1]

[1] On June 30, the Court entered a standing Order requiring investors and creditors to notify the SEC of their positions regarding receivership matters and further directed the SEC to present any such views to the Court. The SEC respectfully requests that the Court consider the objections that have already been filed by investors and creditors [Dkt.#s186, 197, 199, 201 & 205] as those entities' positions regarding the instant Motion to avoid the risk of the SEC misstating those positions. Although the SEC does not object to the standing of creditors and investors to appear and be heard on matters of significance in the Receivership, the SEC understands the Court's concerns and, in order to comply with the Court's Order going forward, the SEC suggests that

1. Preliminary Statement.

The SEC has serious concerns regarding the conduct of this Receivership. The SEC has stated publicly that it disagrees with the Receiver's proposal to invest limited Receivership Property into what appear to be risky and illiquid investments, a course that would be highly unusual for any equity receivership.[2] Because the SEC is mindful that the Receiver is an officer of the Court and has an independent duty to investors, the SEC insisted that the Receiver make his proposals transparent to investors and the Court and seek Court authority for his proposed expenditures. That insistence led to the filing of the Joint Letter by the SEC and the Receiver on May 19 [Dkt.#142]. As is clear from that Joint Letter, the SEC did not seek to substitute its own judgment for that of the Receiver, or the Court, and did not seek to remove the Receiver because of differing views regarding some of the Receiver's proposals.

Subsequent to the filing of the Joint Letter, the SEC staff learned from a third party that (i) the Receiver had an actual conflict of interest, as he personally represented the borrower in a valuable loan transaction made by a Receivership Entity in 2013 that is subject to active renegotiation by the Receivership, and a participant in the loan had alleged that the Receiver was not acting to enforce the loan; (ii) a Guidepost Solutions, LLC employee breached an escrow agreement and returned the funds only after being confronted by the beneficiary of the agreement

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investors and creditors submit their views to the SEC staff in writing, and the SEC staff will file those submissions as attachments to an SEC pleading in connection with the relevant proceeding.

[2] In addition to the Gold Recovery Project which is discussed more fully below, the SEC staff understands, based on conversations with the Receiver's staff, that the Receiver would also recommend investing Receivership cash into a Phase II bio-pharma company, a U.S. based gold mining operation, whose auditor issued a "going concern" letter in its Form 10-K for fiscal year 2015 and which has not filed periodic reports with the SEC since the first quarter of 2016; a U.S. based public oil and natural gas exploration company, whose auditor issued a "going concern" letter in its Form 10-K for the fiscal year ending February 2017; and a U.S. based dormant coal mining operation.

and at the insistence of counsel; and (iii) the same Guidepost employee had solicited the investor's consent to use the money held in escrow to fund the purported Brazilian Gold Recovery Project. In turn, those facts followed on the heels of other disconcerting information the staff had learned of regarding the Receiver or his employee having entered into the Arabella participation agreement on the advice of a conflicted attorney.[3]

When the SEC staff discussed these concerns with the Receiver, he offered to resign, and the SEC staff consented to his resignation.[4] The SEC staff then immediately sought to find an appropriate substitute Receiver, and filed its Motion for entry of the Proposed Second Amended Order Appointing Receiver ("Proposed Order") with the goal of effectuating an orderly wind-down of the Receivership and making distributions to investors.[5]

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[3] The SEC staff first learned of the Arabella participation agreement on April 10, 2017, when the Receiver's counsel forwarded to the staff a draft motion to approve the Arabella settlement agreement and advised the staff that the motion had to be filed the next day. In addition to seeking approval of the Arabella settlement, the draft motion also sought Court approval of the Arabella participation agreement *nunc pro tunc* and permission for the Receiver to pay the attorney up to $300,000 for post-receivership work without the necessity of filing a fee application. Pursuant to the participation agreement, the Receiver had sold a 45% interest in the Arabella Loan to an investor introduced to the Receiver by the attorney representing Platinum on the matter for $500,000, and the proceeds were used in part to pay the attorney's pre-receivership legal bill. Subsequent to that transaction, the Receiver learned that the collateral underlying the loan was more valuable than he had been told. The SEC staff was alarmed that the Receiver would seek *nunc pro tunc* approval of an agreement recommended by a conflicted attorney that paid the attorney a preference for a pre-receivership debt and that had been entered into before the Receiver learned the true value of the underlying collateral. After an extension requested by the SEC staff to ascertain the facts, the staff supported approval of the Arabella settlement but objected to the *nunc pro tunc* approval of the participation agreement and payment of the attorney fees, which the Receiver then omitted from his requested relief. [Dkt.#128]

[4] The staff sought to file its letter under seal to give the Court an opportunity to review the staff's concerns about an officer of the Court before they became public. While there was no intent at gamesmanship, the decision to delay disclosure of the letter to Defendants until the Court ruled on its sealing application was erroneous and the staff apologizes to the Court and Defendants for the manner in which it handled its sealing application generally.

[5] Subsequent to the filing of the Motion, the SEC staff learned of another troubling incident concerning the Receivership. On June 29, Christopher Kennedy, one of the Joint Official

2. The SEC is Fulfilling its Statutory Duty to Protect Investors.

The SEC's role in civil enforcement actions is to protect investors. *SEC v. Mgt. Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975) ("It requires little elaboration to make the point that the SEC appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws."). The SEC staff is also aware that a receiver is an officer of the Court whose powers are derived from the order appointing the receiver. *SEC v. Schooler*, 2015 WL 1510949 at *1 (S.D. Ca., Mar. 4, 2015) ("Generally, a federal equity receiver is an 'officer of the court.'") (*citing In re San Vicente Med. Partners Ltd.*, 962 F.2d 1402, 1409 (9th Cir. 1992). "District courts, therefore, have extremely broad authority to supervise and determine the appropriate action to be taken in a federal equity receivership." *Schooler*, 2015 WL 1510949 at *1 (*citing SEC v. Capital Consultants, LLC*, 397 F.3d 733, 738 (9th Cir. 2005)).

In exercising his or her powers, "[a] receiver owes a duty to exercise reasonable care to protect and preserve the assets of the receivership. In carrying out this duty, the receiver must exercise ordinary care and prudence, that is, the same care and diligence that an ordinary prudent

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Liquidators of Platinum Partners Value Arbitrage Fund L.P. ("PPVA"), a Platinum affiliate subject to a Winding Up Order of the Grand Court of the Cayman Islands and a Chapter 15 Foreign Ancillary bankruptcy case in the Southern District of New York, advised the staff that a Guidepost employee agreed to hold in a separate account $7.7 million in proceeds from the Receiver's February 2017 sale of a loan that PPVA alleged had been fraudulently transferred to a Receivership entity in March 2016, to be used solely to maintain and invest in assets in which PPVA and the Receivership both have an interest. Upon inquiry, a Guidepost employee advised the staff that although PPVA had requested that the funds be segregated, Guidepost never agreed to segregate the funds and the $7.7 million is included in the Receivership's approximately $10 million in unencumbered cash. Earlier today, counsel to the Joint Official Liquidators forwarded a letter that Mr. Kennedy had transmitted to the Receiver, which is attached hereto as Exhibit 1. Mr. Kennedy understood that the proceeds of the February sale would be used only to fund joint interests and would not be considered by the Receiver to be unencumbered Receivership cash. It is disconcerting that the staff learned once again of a potential serious claim that could dramatically restrict the Receivership's cash resources from a third party, in this case another fiduciary, and not from the Receiver. Counsel to the Joint Official Liquidators has advised the staff that he will be present at the July 7 hearing in the event the Court would like to hear from him.

person would exercise in handling his or her own estate, or under like circumstances." SEC *v. Kirkland*, 2012 WL 3871920 at *2 (M.D. Fla., Aug. 1, 2012) (internal citations omitted). *See also Fleet Nat'l Bank v. H & D Entertainment*, 926 F. Supp. 226, 240 n.51 (D. Mass. 1996), *aff'd*, 96 F.3d 532 (1st Cir. 1996).

The Receiver acknowledges that the original Order Appointing Receiver directed the Receiver to "'protect investors' assets' and 'conduct an orderly wind down including a responsible liquidation of assets and orderly and fair distribution of those assets to investors.'" [Joint Letter, Dkt.#142 at p. 3] Yet the Receiver and certain of the Objectors appear to misconstrue paragraph 28 of the Order Appointing Receiver to also provide the Receiver with the power to make new capital investments. [Dkt.#59-2 at p.12]. Paragraph 28 permits the Receiver, without leave of Court, to "transfer, compromise, or otherwise dispose of any Receivership Property, other than real estate, in the ordinary course of business, on terms and in the manner the Receiver deems most beneficial to the Receivership Estate, and with due regard to the realization of the true and proper value of such Receivership Property." The SEC reads this paragraph to permit the Receiver to engage in ordinary course transactions with Receivership Property without leave of Court and to seek to realize the true and proper value of such property when engaging in such ordinary course transactions. The SEC does not read this paragraph to provide authority for the Receiver to make new investments of capital with Receivership Property, and believes that such investments would be inconsistent with the Receiver's duty of care. *Cf. SEC v. Harris*, 2016 WL 1555773 at *13 (N.D. Tex., Apr. 18, 2016) (questioning receiver's rationale of continuing to operate oil wells in

order to preserve value of wells which depleted estate assets when receiver could have sold the wells as is or brought them into compliance and abandoned them).[6]

Although the Proposed Order provides for the liquidation of Receivership Property, the sole purpose of that provision is to make clear that the Receiver should not be making investments of new capital with Receivership Property. It is not designed to force the Receiver into a fire sale. The SEC expects the Receiver to exercise sound business judgment to obtain the highest possible values for the Receivership Property and understands that the Receiver may have to use estate resources to maintain certain investments over a longer period of time in order to realize such value. The SEC is amenable to amending the Proposed Order to make that position clear.[7]

3. The Court Can Approve a Receivership Liquidation Plan.

Certain of the Objectors argue incorrectly that an equity receivership cannot be used to effectuate a liquidation and pro-rata distribution, citing to *dicta* in the Second Circuit's decision in *SEC v. Am. Bd. Of Trade, Inc.*, 830 F.2d 431, 436-38 (2d Cir. 1987). In fact, the Second Circuit has approved receivership liquidation plans subsequent to *Am. Bd. Of Trade* with full recognition of the *dicta* in *Am. Bd. Of Trade. See SEC v. Malek*, 397 Fed. Appx. 711, 714-15 (2d Cir. 2010) (Second Circuit noted that it had "never vacated or modified a receivership order on the ground

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[6] In *Harris*, the District Court had also appointed an examiner to help the Court determine whether the receiver's recommendation regarding the management of oil wells "is a prudent step for the Court or a potentially fruitless and possible depletion of Receivership assets." *See* Order Appointing Examiner, *SEC v. Harris*, 09-CV-1809-B (July 26, 2011) (Dkt. # 213). A copy of the order is attached to this Reply as Exhibit 2.

[7] Certain Objectors also take issue with the requirement that the Receiver seek Court approval for dispositions of Receivership Property of a value of $1million or more, and that the Receiver consult with the SEC staff regarding all dispositions of lesser value and seek Court approval if requested by the SEC staff. The SEC is amenable to increasing the threshold for Court approval if the Court believes an increase is appropriate and would lessen the burden on the Court. However, the SEC believes that it is imperative for the SEC staff to be consulted on dispositions of Receivership Property to provide input to the Receiver for the protection of investors. This would be a consultation requirement, not a veto power.

that a district court improperly attempted to effect a liquidation," and concluded "that the district court did not abuse its equitable discretion in approving the Distribution Plan's liquidation of the receivership estate."), *citing SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80 (2d Cir. 2002) (approving district court's partial liquidation plan). To address the concerns raised by the Objectors, the SEC has always approved of the right of parties in interest to petition a receivership court to justify placing receivership entities into bankruptcy, and the Order Appointing Receiver also permits the Receiver to file bankruptcy petitions subject to Court approval if the Receiver believes it is in the best interests of the estate. None of the Objectors have explained why bankruptcy, with its high administrative costs, rigid priorities scheme that this Court of equity does not necessarily have to follow, and its mandatory motion practice, is appropriate in this case. The Objectors appear to take the implausible position that the Court cannot preside over an orderly wind down, but instead must permit a receiver to reorganize, make new investments,[8] and commence and operate businesses.

4. Potential Receivership Liability From Operation of a Business.

Both the Receiver and certain of the Objectors have ignored the significant potential liabilities the Receivership may incur if the Court permits the Receiver to operate any businesses, let alone the risk-laden enterprises the Receiver was contemplating. 28 U.S.C. § 959(a) provides that "[t]rustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property."

If the Receiver is permitted to build and operate a mining operation in the Brazilian countryside or to operate any other business, he could subject the Receivership to potential

[8] Continuing investments may also cause the Receivership to become an inadvertent investment company subject to registration and regulations concerning investments, which is not contemplated by the Order Appointing Receiver.

environmental and tort liabilities, all of which would have to be paid as administrative expenses ahead of existing investors and creditors. *See, e.g., Medical Dev. Int'l v. Cal. Dep't of Corr. & Rehab.*, 585 F.3d 1211, 1216-19 (9th Cir. 2009) (operating receiver may be sued in his official capacity for acts taken while receiver is operating the business and recovery, if any, will be from receivership assets); *In re N.P. Mining Co.*, 963 F.2d 1449, 1458 (11th Cir. 1992) (holding that 28 U.S.C. § 959 reflects a federal policy that "justif[ies] giving first priority to punitive penalties that are ordinarily incident to operation of a business" in the bankruptcy context). *See also, Reading Co. v. Brown*, 391 U.S. 471, 483-84 (1968) (holding that tort claims that arise from operation of a business in bankruptcy are entitled to priority administrative expense status and analogizing them to the treatment of tort claims in a receivership; "It has long been the rule of equity receiverships that torts of the receivership create claims against the receivership itself.").

5. The SEC has No Objection to the Receiver Making his Proposed Plan Available for the Court and Investors.

Although the SEC consents to the Receiver's resignation based on the circumstances described above in the Preliminary Statement, it has no objection to the Receiver making his recommendations available to the Court, investors, and a substitute Receiver if the Court accepts his resignation. However, in the SEC's view, the Receiver's proposed investments are inconsistent with the Receiver's exercise of his fiduciary duty, and are more consistent with the Receiver acting as a high-risk private equity or venture capital fund manager. For the SEC staff, the most glaring example of this is the Receiver's proposal to invest *at least* $5 million of Receivership cash into the Brazilian Gold Recovery Project.

In his June 23, 2017 letter [Dkt.#180], the Receiver explained that he had conducted extensive due diligence regarding the project and that he could potentially unlock significant value from the project if the Receivership invested at least $5 million of Receivership Property into it.

This project is described in the Receiver's First Quarterly Status Report [Dkt.#130-1 at 21-22] as a "tailings dam," which "is an earth-fill embankment dam used to store byproducts of mining operations," and is located near Cuiaba, Brazil. According to the Receiver, the family-owned mining operation at the site uses an "artisanal mining" approach which extracts "the easier-to-obtain larger pieces of gold through the artisanal process while discarding the tailings" into the tailings dam. There is currently no mining operation to recover the purported gold tailings from the tailings dam. Rather, the Receiver proposes that the Receivership invest money "to put the on-site infrastructure in place to commence the processing of the tailings."[9]

Thus, the Receiver, proposes to invest at least $5 million of the approximately $10 million of investors' cash on hand to build and operate a novel mining operation in the Brazilian countryside that will purportedly collect gold from a dam containing the by-product of artisanal mining operations. Because there is no existing mining operation at the site, this would essentially be a Court-supervised start-up operation by the Receiver using investor money. It is not clear to the SEC why, if the rights to the tailings dam have such potential, their value cannot be realized through a sale to another investment fund.

6. SEC's Position on Pending Motions.

The SEC believes that all pending motions filed by the Receiver should be deferred until such time as the Court appoints a substitute Receiver if the Court accepts the Receiver's resignation. The SEC believes that a substitute Receiver would be capable of prioritizing the matters that require immediate attention and promptly provide a recommendation to the Court.[10]

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[9] Significantly, the Platinum entity holding the rights to the tailings pond did not make an initial, informed investment decision to acquire those rights. Rather, in 2011, one of the Platinum entities made a $10.5 million loan to the owner of the artisanal gold mine secured by an interest in the underlying gold mine. The owner defaulted on the loan in 2013, and in 2016 the owner offered the Platinum entity the rights to the tailings pond in lieu of foreclosure.

The SEC understands that Melanie L. Cyganowski, its proposed substitute Receiver, has reviewed the docket in this case and has familiarized herself with the pending Receiver motions. As a former bankruptcy judge for the Eastern District of New York, the SEC is confident that, in the event the Court accepts the Receiver's resignation and decides to appoint her as substitute Receiver, she will be more than capable of evaluating the investments, negotiating with the various claimants, and make recommendations to the Court. Ms. Cyganowski has advised the staff that, if appointed, she is prepared to meet with investors and creditors to evaluate the Receivership's investment portfolios and discuss options to maximize their value.

7. Conclusion

For all of the foregoing reasons, the SEC requests that the Court enter the Proposed Second Amended Order Appointing Receiver, Appoint a substitute Receiver, and grant the SEC such other and further relief as is just.

Respectfully Submitted,

/s/Neal Jacobson
Neal Jacobson
Kevin McGrath
Adam Grace

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[10] Although Mr. Nordlicht, who controls the Platinum entities that are not in receivership, previously consented to the Receiver's motion to expand the Receivership for the benefit of the Receivership subject to certain conditions [Dkt.#s112 &120], he has now withdrawn his consent in light of the SEC's Motion [Dkt.#204]. Mr. Nordlicht originally consented to entry of the Order Appointing Receiver on December 19, 2016, on the condition that Bart Schwartz, who had acted as "Independent Oversight Adviser" for Platinum with the SEC staff's consent since July 2016, be appointed Receiver. In light of Mr. Nordlicht's withdrawal of consent to the Receiver's motion, the SEC's Proposed Order will need to be modified accordingly, though the SEC reserves the right to include additional entities in the Receivership in the future. If the Court grants the SEC's Motion, the SEC will submit a revised Proposed Order reflecting such modification and any other modifications that the Court may order.

Securities and Exchange Commission
New York Regional Office
Brookfield Place
200 Vesey Street, Suite 400
New York, NY 10281-1022
(212) 336-0095
Jacobsonn@Sec.gov

Of Counsel
Alistaire Bambach