

**IN THE CIRCUIT COURT OF THE 17th
JUDICIAL CIRCUIT, IN AND FOR
BROWARD COUNTY, FLORIDA**

CASE NO.: 12-24051 (07)

COMPLEX LITIGATION UNIT

MATTHEW CARONE, et al.,

Plaintiffs,

v.

MICHAEL D. SULLIVAN, individually,

Defendant.

CONSERVATOR'S LITIGATION STATUS REPORT

Philip J. von Kahle (the "Conservator"), as Conservator for P&S Associates, General Partnership ("P&S") and S&P Associates, General Partnership ("S&P") (together, the "Partnerships"), by and through undersigned counsel, pursuant to this Court's May 6, 2013 *Second Order Resetting Deadlines and Case Management Conference*, hereby files this Conservator's Litigation Status Report (the "Litigation Report"), and in support thereof states as follows:

Brief Introduction

The Conservator was appointed pursuant to this Court's January 17, 2013 *Order Appointing Conservator* ("Conservator Order" or "C.O.).

Prior to his appointment, Margaret Smith, acting on behalf of and for the benefit of the Partnerships, commenced two separate lawsuits:

- *Margaret Smith as General Partner of P&S Associates, General Partnership and S&P Associates, General Partnership, Plaintiffs v. Janet A. Hooker Charitable Trust, e. al.*, Case No. 12-034121 (07) (the "Net Winner Suit"); and

- *Margaret Smith as General Partner of P&S Associates, General Partnership and S&P Associates, General Partnership, Plaintiffs v. Michael D. Sullivan, et al.*, Case No. 12-034123 (07) (the “Insiders Suit”) (together, the “Lawsuits”).

The Conservator was charged with, among other things, investigating the claims and causes of action of the Partnerships, including the Lawsuits, and reporting to this Court whether such claims ought to be pursued for the benefit of the Partnerships. (C.O. at 3.)

After review of the available books and records of the Partnerships and noting the failure of certain of the Partnerships’ insiders to turnover certain documents demanded by the Conservator, the Conservator believes the Lawsuits ought to be pursued.

Each of the Lawsuits claim damages in the millions of dollars. If successful, the Lawsuits may provide the Partnerships (and by extension their general partners) significant additional recoveries.

The Conservator believes engaging counsel on a contingency fee basis with a \$50,000 cap on reimbursable costs for each matter (approximately 1.8% of the assets of the Partnerships) is in the best interests of the Partnerships, reduces their exposure and maximizes their potential recoveries.

The Conservator bases his opinion on, among other things, the following:

The Net Winner Suit

The Net Winner Suit names as defendants those particular partners of the Partnerships who received, on a net basis, more money than they invested; i.e., ‘Net Winners’. It is undisputed that, as a function of solely investing in Bernard L. Madoff Investment Securities,

LLC (“BLMIS”),¹ the Partnerships did not earn any legitimate income. In traditional ponzi-fashion, all distributions to the Partnerships’ partners came out of Partnership capital, not profit (there being none). Pursuant to their respective operative agreements, the Partnerships were only permitted to distribute actual profit.

Thus, for the reasons stated in the Net Winner Suit complaint and others,² each of the Partnerships have claw-back claims against the individual partners who received more distributions than they made contributions. These proceeds will inure to the benefit of the Partnerships and, ultimately, to those general partners who contributed more to the Partnerships than they received in distributions; i.e., ‘Net Losers’.³

After a diligent review of the available Partnerships records, the Conservator has determined that approximately 124 ‘Net Winners’ exist and that claims against the ‘Net Winners’ exceed \$8,473,000.00.⁴

If the Net Winner Suit is successful against all Net Winners, the Partnerships could realize a recovery of millions of dollars.

¹ In December of 2008 it was discovered that BLMIS was one of the largest ponzi-scheme fraudulent enterprises that the world had ever seen.

² In the ponzi context Court’s have nearly uniformly agreed that payments received by investors in excess of their investment are recoverable as fraudulent transfers. *In re Dreier LLP*, 452 B.R. 391, 440 n. 44 (Bankr. S.D.N.Y. 2011) (“[V]irtually every court to address the question has held unflinchingly that to the extent that investors have received payments in excess of the amounts they have invested, those payments are voidable as fraudulent transfers.”) (citation omitted).

³ The fictitious profits distributed to the Net Winners could only be comprised of the capital contributions of the Net Losers. Principals of equity and partnership law require the Net Winners to give back the false profit for the benefit of the Net Losers.

⁴ To conserve resources and in the interest of efficient administration, the Conservator recommends pursuing claims against those partners whose ‘net winnings’ exceed \$50,000.00. Based on the available records, it appears that approximately \$7,077,000.00 in claims should be pursued against approximately 36 ‘Net Winners’.

Therefore, the Conservator recommends advancing the Net Winner Lawsuit to allow the Partnerships and their partners to receive a substantial benefit.

To that end, on April 24, 2013, the Conservator filed his *Motion to Retain and Compensate Berger Singerman, LLP as Special Litigation Counsel in the ‘Janet A. Hooker Charitable Trust, et. al.’ Matter and Approving the Contingency Fee Compensation Agreement* (the “Net Winner Retention Motion”). The Conservator hereby adopts and incorporates by reference the arguments and the prayer for relief contained in the Net Winner Retention Motion and seeks this Court’s approval to engage counsel and advance the Net Winner Suit.

The Insider Suit

The Insider Suit concerns alleged improprieties, including breaches of fiduciary duties and negligence, committed by, among others, the Former General Managing Partners, former employees of the Partnerships, and others who improperly received funds and/or assisted others in breaching their duties (the “Defendants”).

After a diligent review of the available Partnerships records, the Conservator has confirmed that evidence exists to support certain allegations contained in the Insider Suit’s complaint (the “Insider Complaint”).

Specifically, the Conservator has identified documents reflecting or tending to evidence, among other things, the following allegations of the Insider Complaint:

- Investors’ money (much of which was never invested, in BLMIS or otherwise) was used to pay Sullivan and a number of shell entities he set up for that purpose unearned and excessive ‘management fees’ numbering in the many millions of dollars. One such entity is Defendant Michal D. Sullivan & Associates, Inc.
- The assets of the Partnerships were funneled to Sullivan and other Defendants in the form of ‘commissions’ or ‘referral fees.’

- Millions of dollars given to Sullivan to invest were never even invested, contrary to Sullivan's obligations and responsibilities under the Partnership Agreements, and his representations to the general partners themselves.
- Sullivan earmarked tens of thousands of dollars in "fees" to Frank Avellino and Michael Bienes, two individuals who are prohibited by the Securities and Exchange Commission from participating in the sale of securities.
- Unauthorized payments in excess of \$700,000 were made to Kelco Foundation, disguised as charitable contributions, and were in actuality commissions for referrals investors to the Partnerships.

As of the date of the Litigation Report, certain of the Defendants have failed to turnover information demanded by the Conservator in connection with his investigation of the Partnerships' litigation claims.

The claims for damages in the Insider Suit against the Defendants totals in the millions of dollars.

If the Insider Suit is successful, the Partnerships could recover a significant sum for the benefit of the Partnerships. Such funds would then be available for distribution to their general partners.

Therefore, the Conservator recommends advancing the Insider Suit to allow the Partnerships and their partners to receive a substantial benefit.

To that end, on April 24, 2013, the Conservator filed his *Motion to Retain and Compensate Berger Singerman, LLP and Messana P.A., as Special Litigation Counsel in the 'Michael D. Sullivan, et al.' Matter and Approving the Contingency Fee Compensation Agreement* (the "Insider Suit Retention Motion"). The Conservator hereby adopts and incorporates by reference the arguments and the prayer for relief contained in the Insider Suit Retention Motion and seeks this Court's approval to engage counsel and advance the Insider Suit.

Retaining Special Counsel to Advance the Lawsuits

Pursuant to the Conservator Order, the Conservator's powers include, with Court approval, the ability to "retain, others to provide legal or accounting services as may be necessary during the period of the Conservatorship." C.O. at 6. On April 24, 2013, the Conservator filed his Net Winner and Insider Suit Retention Motions.

Pursuant to the proposed terms of their respective engagements, special counsel will be engaged to pursue the Net Winner Suit and Insider Suit for the benefit of the Partnerships on a contingency fee basis with reimbursement of reasonable and necessary expenses.

As a further protection for Partnership resources, the Net Winner and Insider Suit Retention Motions cap costs associated with the Lawsuits at an amount of \$50,000.00 for each suit.

By pursuing the Lawsuits in this manner the Partnerships have an opportunity to realize a substantial benefit while minimizing their exposure to costs and expenses. Such an arrangement furthers the interests of the Partnerships and their partners. Moreover, by retaining counsel proposed by the Net Winner and Insider Suit Retention Motions the Partnerships will be able to promptly advance the Lawsuits without encountering the delay necessarily attendant to retaining counsel unfamiliar with the facts and issues.

Conclusion

After review of the available records, the Conservator concludes that there is sufficient evidence to recommend advancing the Lawsuits for the benefit of the Partnerships.

Advancing the Lawsuits, by engaging counsel under the terms of the Net Winner and Insider Suit Retention Motions, maximizes the Partnerships potential recovery (which could

be in the millions of dollars) and reduces the out of pocket costs and risks of litigation.

Dated: May 20, 2013

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