

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES SECURITIES AND
EXCHANGE COMMISSION,

Plaintiff,

v.

EQUITYBUILD, INC., EQUITYBUILD
FINANCE, LLC, JEROME H. COHEN, and
SHAUN D. COHEN,

Defendants.

Case No. 1:18-cv-5587

Hon. John Z. Lee

**LIBERTY EBCP, LLC'S RESPONSE TO MOTION FOR ENTRY OF AN
ORDER: (1) ESTABLISHING CLAIMS BAR DATE; (2) FINDING THAT
THE RECEIVER GAVE FAIR, ADEQUATE, AND SUFFICIENT
NOTICE TO ALL INTERESTED PARTIES; AND (3) APPROVING
PROOF OF CLAIM FORM AND SUMMARY PROCEDURES**

Liberty EBCP, LLC, through its undersigned counsel, files this Response to Motion for Entry of an Order: (1) Establishing Claims Bar Date; (2) Finding that the Receiver Gave Fair, Adequate and Sufficient Notice to all Interested Parties; and (3) Approving Proof of Claim Form and Summary Procedures (the "Claims Motion").

SUMMARY

Liberty does not oppose the establishment of a claims procedure. However, the claims procedure has been designed to postpone, for up to a two-year period of time from the filing of this Receivership case, the adjudication of the validity of the, to date, uncontested mortgages of Liberty. Since the filing of the Receivership case:

- a. Liberty has not received a single payment of principal or interest on its loan;
- b. Liberty's rent collateral proceeds have been illegally diverted for other Receivership purposes;

- c. The Receiver has failed and refused, despite being under an order of this Court to do so, to account for and return to Liberty the diverted rent collateral;
- d. The Receiver has failed and refused to permit Liberty to engage in any direct manner (or through the Receiver, as demanded by the Receiver six months ago, but then ignored) with the property managers over Liberty's collateral properties, to maximize their values, notwithstanding Liberty's contractual right to do so under its loan documents; and
- e. As a result of the diversion of Liberty's rents, taxes are unpaid on Liberty's collateral properties, accruing interest at 18 percent per annum.

Because the deprivation of Liberty's due process rights are hindered through a diminution of its collateral's value, each day that this Receivership progresses, without proper adequate protection of Liberty's interests (which, to date, has not been granted by this Court), Liberty must insist that the claims process, which is the underpinning of the Receiver's excuse for the denial of Liberty's due process rights, not stand in the way of Liberty's right to protection of its collateral position.

FACTS

The basis for Liberty's objection is premised on the following provisions of the Claims Motion:

- a. The Receiver seeks a bar date for claims "approximately 120 days from entry of the order approving the Claims Motion." Claims Motion, Page 5.
- b. The Receiver "anticipates that investigating and calculating the claims of investors and creditors will take at least a year from the proposed bar date." Claims Motion, Page 4.

- c. “The Receiver has not set a time frame for the processing of claims” but “[i]nstead is asking the Court to set a status date thirty (30) days after the Bar Date for the Receiver to report at least initially on the general response to the claims process.” Claims Motion, Page 9.
- d. “The Receiver intends on proposing a discovery schedule to the Court to account for any reasonable discovery that the parties to the litigation, the Receiver and claimants deem necessary and appropriate. Ideally, the Receiver believes that such discovery would be completed in advance of the submission of a proposed distribution plan, but that can be discussed further in the proposed status conference.” Claims Motion, Pages 9-10.

By its own admission, the Receiver never consulted with Liberty (or the other mortgagees) regarding the Claims Motion. “The Receiver has consulted with counsel for the Securities and Exchange Commission, and the SEC does not oppose the Motion.” Claims Motion, Paragraph 10.

On February 7, 2019, this Court ordered the Receiver to file the Claims Motion by February 22, 2019. The Claims Motion was to include a procedure for limited discovery as directed by this Court at the December 18, 2018 status hearing:

THE COURT: It seems to me that that sort of limited discovery may be something that can be built into the claims process... Because while certain interest-holders may want some limited discovery, others may not. So perhaps that’s something the receiver can thank [sic] about and talk to the various parties about, so that whatever questions they have can be addressed in the information that the receiver has.¹

¹ At this hearing, counsel also requested that the Receiver turnover to the mortgagees documents referenced in the Complaint, including certain assignments in which SEC alleged that “the investors assigned to Equitybuild Finance, as the ‘Collateral Agent,’ all of their rights and powers under the Notes and mortgages.” Complaint, ¶ 25. DKT. 1. Such documents were referenced at the outset of this case, are highly relevant to the lien priority dispute, and still have not been produced to the mortgagees – even though the Receiver has demanded and received extensive documentation from the mortgagees.

The Receiver did not ask for Liberty's position regarding discovery and did not build any discovery component into the Claims Motion, as requested by this Court.

The Receiver has disclosed to this Court that it has obtained and recovered substantial amounts of information, to date, regarding Liberty and the other mortgagees' loans, as noted in the Receiver's Second Status Report [DKT. 258] (the "Second Status Report"):

[T]he Receiver and his retained professionals have been reviewing and analyzing the following: (i) documents and correspondence sent to or received from the EquityBuild principals, to whose email accounts the Receiver has access; (ii) bank records from EquityBuild and its affiliate entities; (iii) EquityBuild documents (largely stored in cloud-based and other electronic media, although some received in paper form); (iv) available underlying transaction documents contained in the files of former Chicago-based EquityBuild counsel received to date; and (v) files produced by former EquityBuild securities counsel, accountants, and employees. Moreover, the Receiver has requested documents and records from the Cohens (including those called for by the Order Appointing Receiver), some of which remain outstanding.

The Receiver and his retained professionals have also collected, reviewed, and analyzed all available loan documentation associated with the financing or refinancing, through various lenders, of substantially all of the EquityBuild portfolio during the 2017-2018 time frame. Among other efforts, the Receiver and his professionals have endeavored to ascertain the terms of the loans and the current loan balances, and to obtain and review available due diligence materials submitted by EquityBuild in connection with the original loan applications.

Second Status Report, Pages 4-5 (emphasis added).

The Receiver further disclosed in the Second Status Report that:

[T]he Receiver has: searched the cloud-based and other digital media received from the Receivership Defendants; reviewed information supplied directly by investors (including mortgages and account statements); and consulted available bank records. In addition, many investors have reached out to the Receiver to identify themselves, the amount of their investment, and, in many instances, have provided documents.

Id. at p. 15.

ARGUMENT

A. The Claims Motion should not be deemed to impair, in any way, Liberty's right to seek discovery from the Receiver of Receivership documents related to Liberty's loan, mortgages or their priority.

The Receiver has repeatedly gone on record and represented to this Court that he is contesting the liens of the mortgagees, including the liens of Liberty. Such assertions must be raised in good faith, pursuant to Rule 11 of the Federal Rules of Civil Procedure. As such, the Receiver must have in his possession information or facts that he believes provide a good faith basis for representing to this Court that Liberty does not hold first priority liens on its collateral. As a result, there should be no delay in the Receiver turning over such information that is currently in the Receiver's possession and that serves as the basis of the Receiver's allegations to this Court.

Requiring such information from the Receiver is not burdensome, as the Receiver has already acknowledged his review and cataloging of the same. Disclosure of such information is akin to the mandatory disclosure requirements in federal cases, which are utilized to expedite – rather than hinder – a resolution of litigation. FED. R. CIV. P. 26(a)(1).

It is patently unfair to allow the Receiver the benefit of this information in his possession for numerous months but refuse to provide it under the auspices of a lengthy and drawn-out claims procedure. Rather, the Receiver can simply provide information now that he has in his possession and that he is relying on to dispute Liberty's lien position and/or that supports an alleged third party's lien priority and can provide additional information on a rolling basis to supplement such information once the claims bar date has passed.

Whatever the duration of the claims process, any order approving the Claims Motion should not limit Liberty's ability to seek discovery, from the Receiver, of Receivership documents which support the Receiver's challenge to the validity of Liberty's mortgages and loan. These

Receivership documents would include all documents and communications (including emails) relating to the origination and closing of Liberty's loan, as well as all documents and communications related to the Receivership defendants' or entities' relationship with investors who the Receiver claims have a superior interest in Liberty's collateral. A prime example would be the alleged servicing agreements executed by each of the investors, who the Receiver asserts may have a claim superior to Liberty in the Liberty collateral. There is absolutely no reason why the Receiver, while soliciting claims information from third parties, cannot work on a coordinated set of discovery disclosures as to those documents admittedly already within the Receiver's possession, but merely being withheld for leverage purposes.

B. The claims process should be shortened to a period of sixty-days after the solicitation materials are received by the claimants, not one hundred and twenty-days.

The claims process requested by the Receiver has already been unduly delayed and is proposed to be unacceptably drawn out. Compare the timing of the claims process proposed by the Receiver in the Claims Motion to a recent SEC Receivership before the District Court of the Northern District of Illinois which involved multiple stock issuers and an estimated 40,000 shareholders. *S.E.C. v. Pearson*, Case No. 14-3785 (N.D. Ill. 2014). The *Pearson* SEC receiver was appointed on May 22, 2014. The receiver filed the claims bar date motion two-months after its appointment, on July 23, 2014, and requested a claims bar date of September 30, 2014 (two-months thereafter). In the current case, the Receiver, was appointed on August 17, 2018, and the Claims Motion was not filed until more than six months after the Receiver's appointment. Based on the period needed for Court approval and the proposed four-month claims submission period, claims will not be due in this Receivership case until more than eleven months after the Receiver's appointment. While the Court has no ability to unwind the six-month plus period it took for the

Claims Motion to be filed, the Court does have the ability to reduce the requested four-month claims submission time period to a more reasonable two-month period.

C. In approving a claims process, Liberty should not be deemed to have waived or be precluded in any way from seeking an adjudication of its claims, including renewal of claims asserted in matters denied without prejudice by this Court previously or new matters, such as a new or renewed right to adequate protection or relief from the automatic stay.

The clear undertone of the Claims Motion is that Liberty and other mortgagees should, as a result of this Court's approval of the Claims Motion, be precluded for coming forward to assert whatever rights they have until the claims process runs its course and a discovery pre-trial hearing is held (possibly thirty-days thereafter, meaning a year after the Receivership was filed). Liberty asserts that any approval of the Claims Motion should be without prejudice to Liberty's right to assert any claims previously denied without prejudice by this Court at prior hearings and/or as to any new matters that Liberty might assert, such as a new or renewed motion to seek adequate protection or relief from the stay imposed under the Receivership Order.

As this Court is aware, based on the Receiver's trumped up allegations of the invalidity of the loans of the various mortgagees, including the loan of Liberty, all mortgages are subject to an alleged challenge. Unfortunately, those mortgages are of record, have never been avoided and are currently subject to a contractual right to payment. However, Liberty and the other mortgagees have not been paid **any** amounts due and owing under their respective loan documents, including principal and interest. Nor during this period has the Receiver escrowed or even allocated any payments of principal, interest or other amounts as required under the various loan documents. And, the Receiver has instead dissipated Liberty and the other mortgagees' rents and to date, has failed to repay them, causing taxes to go unpaid.²As such, the parties' respective collateral

² Per this Court's Memorandum Opinion and Order dated February 13, 2019 [DkKT 223]

positions continue to decline during the pendency of the Receivership without any adequate protection.

Not only is the failure to make such payments in contravention of the loan documents, but also squarely contravenes existing case law. A receiver cannot unilaterally withhold payment to secured mortgagees as noted by the SEC's own leading real estate Ponzi scheme case. *S.E.C. v. Madison Real Estate Grp., LLC*, 647 F. Supp. 2d 1271, 1276 (D. Utah 2009); *see also United States v. EquityBuild, Inc.*, No. 18 CV 5587, 2019 WL 587414, *3 (N.D. Ill. Feb. 13, 2019) (which this Court, in its Memorandum Opinion cited for the proposition that "the rights of receivers can be no greater than those of their predecessors in title."). Indeed, the *Madison* court held that lenders were required to be restored to their status quo under their mortgages, including the payment of principal and even default interest. *Madison*, 647 F. Supp. 2d at 1284-85.

Here, the Receiver has and continues to seek to use the lien priority dispute as a shield to avoid making any payments to any mortgagees and to otherwise freeze Liberty and the other mortgagees in their tracks, while the claims process grinds along.

Accordingly, Liberty is requesting that the order approving the Claims Motion specifically

(the "Memorandum Opinion"):

The Receiver must: (1) not commingle the Rents and use the Rents from each property solely for the benefit of that particular property; (2) separately account for the Rents and provide a monthly accounting upon request; and (3) restore the Rents, to the extent that there are enough funds now or later, if they have been used for the benefit of other properties.

Memorandum Opinion, p. 9. In response to the Memorandum Opinion, the Receiver states in the Second Status Report that: "In the coming weeks, the Receiver, working in connection with his counsel, accountants, and property managers will provide the lenders with documents and reporting information required by the February 13, 2019 order." Receiver Report, p. 13. Nothing, however, has been provided, nor a promise date given.

provide that its entry in no way limits Liberty's right to seek to renew any matters previously brought before this Court and denied without prejudice (including per this Court's Memorandum Opinion and Order dated February 13, 2019) or any new matter that Liberty may seek to assert, including but not limited to the right to seek to enforce the Memorandum Opinion and Order, a new or renewed right to adequate protection or a right to relief from the automatic stay.³ The claims process under the Claims Motion should have no impact on the right of Liberty to protect its legal rights in this Receivership.

REQUESTED RELIEF

Liberty therefore requests that any order approving the Claims Motion:

- a. State that its entry does not impair, in any way, Liberty's right to seek discovery from the Receiver of Receivership documents related to Liberty's loan, mortgages or their priority or any defenses the Receiver may have to the foregoing;

³As noted in the *Madison* real estate Ponzi scheme decision, a receiver may not retain commercial real estate property in a receivership if: (1) the property's value does not exceed the value of the secured indebtedness and (2) the receiver fails to satisfy the obligations of the mortgage on an ongoing basis and while the property is in receivership:

Because there is sufficient equity in the property, the court concludes that the advantages of keeping the property in the Receivership exceed the disadvantages to Midland. **This conclusion, however, is contingent upon the Receiver restoring status quo to Midland and maintaining it. The Receiver has not serviced the loan or paid property taxes on Westgate Villas property since the Receivership assumed control of the property.** As discussed in Section I, to justify retaining property in a receivership, one must preserve the status quo of the lender.⁸⁰ **Accordingly, the Westgate Villas property may be retained by the Receivership as long as it brings current the regular, monthly principal and interest payments that have not been paid.⁸¹ It must also continue to pay timely the regular, monthly principal and interest payments, as well as the property taxes, as long as the property is held by the Receivership. If the Receiver is unable to meet these terms, the Receiver must relinquish the property and allow it to proceed to foreclosure.**

Madison Real Estate Grp., LLC, 647 F. Supp. 2d at 1284–85 (emphasis added).

- b. Approve a claims process that requires the submission of claims within a two-month (sixty-day) and not a four-month (one hundred and twenty-day) period; and
- c. Not constitute a waiver or be deemed to precluded Liberty, in any way, from seeking an adjudication of any of its claims, including renewal of claims asserted in matters denied without prejudice by this Court previously (including under the Memorandum Opinion) or any new matters, including, but not limited to, a right to enforce the terms of the Memorandum Opinion, a new or renewed right to seek adequate protection, relief from the automatic stay or other relief.

Dated: March 13, 2019

Respectfully submitted,

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