UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

STRAIGHTPATH VENTURE PARTNERS LLC, et al.,

Defendants.
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22-cv-3897 (LAK)

MEMORANDUM AND ORDER

LEWIS A. KAPLAN, *District Judge.*

Plaintiff, the Securities and Exchange Commission ("SEC"), brought this action against StraightPath Venture Partners LLC, StraightPath Management LLC (together with Straightpath Partners, the "Straightpath Entities"), and the three founders and beneficial owners (the "Founder Defendants") as well as a former manager (together with the Founder Defendants, the "Individual Defendants") of StraightPath for alleged violations of the federal securities laws, including the Investment Advisers Act of 1940, and the rules promulgated thereunder. The Founder Defendants subsequently were indicted, and now await trial, on multiple counts of fraud and one count of obstruction of justice.[1]

The essence of the various claims and charges is that the Individual Defendants caused the Straightpath Entities or funds run by them fraudulently to obtain approximately $393

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1 *United States v. Castillero,* 23-cr-0622 (JMF).

million of investor funds, ostensibly to acquire for the benefit of investors so-called "shares" in private companies that allegedly had the potential to "go public" or have another "Liquidity Event" ("Pre-IPO Shares"). The Individual Defendants ultimately used about $272 million to acquire Pre-IPO Shares. But investor funds were commingled and used also for purposes other than those intended, and the investors were charged excessive and undisclosed markups in acquiring the Pre-IPO shares. Moreover, it appears that there was a substantial shortfall in the Pre-IPO Shares actually acquired.

In 2023, the defendants in this case consented to the entry of a preliminary injunction, a freeze order, and the appointment of a receiver to oversee the assets of the funds and the StraightPath Entities. The receiver then formulated a proposed plan of distribution of the receivership assets,[2] considered comments from 45 of the 2,200 investors as well as the Founder Defendants,[3] and now now moves for an order approving the proposed plan of distribution.[4] The Founder Defendants oppose the motion on a variety of grounds.[5] The SEC unreservedly endorses the receiver's proposed plan.[6]

1. The Founder Defendants acknowledge that the receivership order to which

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[2] Dkt 368-1.

[3] Dkt 349.

[4] Dkt 366.

[5] Dkt 382.

[6] Dkt 381.

they consented (Dkt 56) authorizes the receiver to propose a distribution plan "if appropriate."[7] They contend, however, that the proposal is premature and therefore inappropriate.[8] In the main, they contend, among other things, that the receiver should hold on to the shares of the remaining Pre-IPO Companies that she retains in the hope that they eventually will have successful initial public offerings and generate more money for the receivership estate. In other words, they argue that such a course would be more in line with investors' original expectations.[9]

As the receiver contends — with the support of the SEC — "Investor expectations are not necessarily determinative of a proper distribution in receiverships particularly on the facts of this case where Investor expectations were consistently thwarted by StraightPath's extensive commingling and diversion of Investor cash."[10] Because of this diversion and commingling, as well as the shortfall in shares of the remaining Pre-IPO Companies, investors already have been defrauded of the benefit of their bargains, and the receiver's difficult task is to ensure that they are able to recover some of their expected investment. Moreover, the plan of distribution explicitly requires the receiver to "hold and maintain the [remaining] Pre-IPO Shares" for two years in anticipation that there may be a future liquidity event, unless the receiver determines that earlier liquidation of those shares would generate proceeds "in an amount at least equal to the Silo Share Amount for those Pre-

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7 Dkt 382 at 17.

8 *Id.*

9 *Id. at* 18, 22.

10 Dkt 387 at 7; Dkt 381 at 3-6.

IPO Shares."[11] In essence, the plan of distribution anticipates the Founder Defendants' objection and does not require the receiver to liquidate prematurely Pre-IPO shares at a loss, only allowing her to liquidate after a period of years in order that this litigation not drag on in perpetuity. The Court, in its discretion, finds this provision to be fair, reasonable, and appropriate in the circumstances.

2. The Founder Defendants next claim that the proposed plan improperly would convert the receivership into a liquidation proceeding by authorizing the liquidation of all pre-IPO shares without Court approval.[12] They ignore, however, the facts that (1) the receivership order to which they consented and which the Court previously approved specifically authorized the receiver to (a) "take any action which, prior to the entry of this Order, could have been taken by the officers, directors, members, managers, trustees, and agents of the Receivership Entities" and (b) "take such other action as may be approved by this Court,"[13] and (2) StraightPath's governing documents, as the receiver has shown, permitted entities which now are receivership entities within the meaning of the receivership order to "sell all or any part of any Investment . . . whether for cash, securities, property or on such terms as the Manager shall determine to be appropriate."[14] Moreover, the receivership order expressly "directed" the receiver "to develop a plan for the fair, reasonable, and efficient recovery *and liquidation* of all remaining, recovered, and recoverable Receivership

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11 Dkt 368-1 at 26.

12 Dkt 382 at 19-21.

13 Dkt 56 at 4-6 (clauses IV.F, IV.O).

14 Dkt 387 at 9-10 & n.10.

Property."[15] And finally, as stated above, the plan of distribution does not require — in fact, does not allow — the liquidation of Pre-IPO Shares for two years *unless doing so would be profitable for investors*.[16] Even after two years, the receiver is "authorized, but not required," to sell any such investment only in her expert discretion and if she chooses to do so, she must follow strict procedures designed to generate the highest returns for investors.[17] The Founder Defendants thus fundamentally misunderstand the powers and authority of the receivership order and misconstrue the plan of distribution as a fire sale liquidation.

3. The Founder Defendants object also to the proposed *pro rata* distribution of a portion of the receivership assets.[18] They claim, first, that this matter is not analogous to the Ponzi scheme cases to which this rule previously has been applied and second that any *pro rata* distribution would reward investors "arbitrarily" as compared to an attempt to honor investors' initial investment decisions.[19]

To begin, nothing in the Second Circuit's case law limits *pro rata* distributions to Ponzi schemes. While the court in *S.E.C. v. Credit Bancorp, Ltd.* held that "use of a *pro rata* distribution" was "especially appropriate for fraud victims of a 'Ponzi scheme,'" its logic by no

15 *Id.* at n. 10 (quoting Dkt 56 at 17).

16 Dkt 368-1 at 26.

17 *Id.* at 27.

18 Dkt 382 at 21-22.

19 *Id.*

means was restricted to such situations, applying instead to all cases in which "the funds of the defrauded victims were commingled and where victims were similarly situated with respect to their relationship to the defrauders."[20] Indeed, other courts subsequently have applied the logic of *Credit Bancorp* to non-Ponzi situations in which "any distinctions that might be drawn among parties receiving funds would be arbitrary or based on mere chance," as is the case here.[21] In any event, the Founder Defendants do not contest the basic fact that the Second Circuit approves *pro rata* distributions where (1) funds have been commingled and (2) investors are similarly situated, and the Court agrees with the Receiver's analyses that both factors have been met in this context.[22]

In addition, the Founder Defendants overemphasize the *pro rata* component of the plan of distribution, to the neglect of the significant "silo" component that the receiver proposes. As explained extensively in the moving papers, the receiver's hybrid plan seeks to accommodate the objections of investors who favor conflicting proposals of pure *pro rata* distribution versus pure "benefit of the bargain" distribution. Under the proposed plan, only investors whose funds were earmarked to a particular investment will share in the recovery from that investment after a liquidity event up to the amount that StraightPath paid to acquire it, with any excess funds recovered to be shared *pro rata* among all investors.[23] Thus, the Founder Defendants largely ignore the fact that investors *will* receive the "benefit of their bargains" up to the amount of StraightPath's initial

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20 290 F.3d 80, 88-89 (2d Cir. 2002) (collecting cases).

21 *In re The Reserve Fund Sec. & Derivative Litig*, 673 F. Supp. 2d 182, 196 (S.D.N.Y. 2009).

22 Dkt 367 at 15-18.

23 *See, e.g., id.* at 13.

investment, prioritizing those who made more successful investment decisions (or believed that they were doing so) while utilizing any fruitful gains to offset fraudulent losses and misuse of funds across all investors.

Nonetheless, the Court agrees with the receiver that a pure "benefit of the bargain" plan would be unfair and would fail to make investors whole, contrary to the claims of the Founder Defendants and some investors. StraightPath allegedly pooled investor funds to be used as StraightPath needed, rather than as each investor intended. As a result of such extensive commingling, while individual investors may believe that shares of a specific company are "theirs," in reality those shares frequently were purchased using funds from *different* investors. Thus, the capital contributions of others are propping up their intended investments. Moreover, because StraightPath allegedly charged different markups for different companies, there is no fair way to return to each investor his or her intended investment. The capital contribution from investor A, for example, may have been used to create less of a shortfall in investor B's company than investor A now suffers in his or her own intended investment. Given this state of affairs, the receiver's proposed plan is fair and reasonable. It attempts to return to each investor the value of his or her investment up to the amount that StraightPath invested in each company, and then distributes any excess recovery *pro rata* to all investors to (1) offset the losses of those investors whose funds were used to prop up more valuable investments, (2) compensate investors whose investments were allocated to pre-IPO companies that may ultimately be liquidated by the receiver at prices less than their true value, and (3) award successful investors a portion of the profits they otherwise would have earned. The Founder Defendants' objections are unpersuasive.

4. The Founder Defendants object to the proposed distribution of the Escrow Funds and surplus Pre-IPO Shares prior to the adjudication of the SEC's claims against the defendants. The Court can readily dismiss that argument. The Receivership Order says nothing about the receiver's plan of distribution being contingent on the findings in the SEC action, but rather authorizes the receiver to propose a plan without any reference to the SEC outcome.[24] In addition, with regard to the Escrow Funds specifically, the Receivership Order explicitly states that "[t]he Receiver may use the Escrow Funds for *any appropriate purpose*," and only the "portion of the Escrow Funds remaining at the end of the receivership" shall be maintained to "satisfy any judgment against the [Individual Defendants] in this Action."[25] And the surplus Pre-IPO Shares, like all other Pre-IPO Shares owned by the StraightPath Entities, now are property of the receivership and thus may be included in any proposed plan of distribution put forward by the receiver.[26] Any arguments to the contrary are unpersuasive.

5. Finally, the Founder Defendants and some investors object to the treatment of the receivership as a Qualified Settlement Fund ("QSF"). Among other things, they contend that (1) the receiver was not required to create a QSF under the Receivership Order, and thus it was inappropriate for her to do so; (2) the receivership does not meet one of the requirements for treatment as a QSF under 26 C.F.R. § 1.468B–1 of the regulations under the Internal Revenue Code;

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24 *See generally* Dkt 56; *see also* Dkt 387 at 6 (collecting cases).

25 Dkt 56 at 13-14 (emphasis added).

26 *Id.* at 3.

and (3) there were "alternative approaches" that the receiver could have taken instead of defaulting to QSF status.[27]

First, the Receivership Order contains clear non-discretionary language directing the receiver to establish and treat the receivership as a QSF. Under Section XI of the Order, the receiver is required to "take all necessary steps to enable to the Receivership Funds to obtain and maintain the status of a taxable 'Settlement Fund,' within the meaning of Section 468B of the Internal Revenue Code . . . . The Receiver shall cause the Settlement Fund to pay taxes in a manner consistent with treatment of the Settlement Fund as a 'Qualified Settlement Fund.'"[28] As the receiver points out, it is common for courts to direct receivers to establish QSFs in their receivership orders.[29]

Second, the receivership meets the criteria for treatment as a QSF under the law. Regulation § 1.468B–1© sets out a three-prong test that must be satisfied to establish a fund, account, or trust as a QSF. The Founder Defendants — and some investors as well — challenge only the satisfaction of the second prong of that test: that the fund be "established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability . . . [a]rising out of a tort, breach of contract, or violation of law."[30] They contend that the receivership

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27 *See, e.g.*, Dkt 382 at 26-29.

28 Dkt 56 at 15.

29 *See* Dkt 367 at 25 n.31.

30 26 C.F.R. § 1.468B–1(c)(2); *see* Dkt 382 at 27-28; Dkt 396.

instead was created for the purpose of "marshal[ing] and preserv[ing] the assets of the Receivership Estate and the Escrow Funds pending the outcome of the Action, not to resolve claims of liability."[31]

This objection ignores the clear aim of the receivership to resolve the claims of *numerous* parties to this litigation, including investors, claimants, and even the receivership estate itself. The receiver undoubtedly is empowered to provide a resolution for investor claims through "recovery," "liquidation," and "distribution of the Receivership Property to investors in any of the SP Funds," thereby satisfying investor demands against the defendants.[32] The receiver has been entrusted to settle also claims brought by claimants against the StraightPath Entities, as visible by the receiver's actions thus far and by the requirement that the receiver file a quarterly report with the Court detailing "[a] list of all known creditors with . . . the amounts of their claims" and "[t]he status of any creditor claims process or proceeding."[33] And for good measure, the Receivership Order expressly grants the receiver the power and authority of the officers and directors of the StraightPath Entities, including the obligation to "pursue and preserve all of their claims" — a power that is reinforced through an entire section entitled "Investigat[ing] and Prosecut[ing] Claims."[34]

Lastly, the Court agrees with the receiver that the alternative approaches advocated for are not available in this context. Notably, transfer of the receivership property to an "outside"

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31 Dkt 382 at 27.

32 Dkt 56 at 17.

33 *Id.* at 18-19; *see also* Dkt 180 (Order granting Receiver's Motion for Establishing Procedures for Resolution of Claims and Interests and Setting Bar Dates for Claims).

34 Dkt 56 at 4, 15.

entity would create complex and confusing tax implications and would require clearing significant hurdles regarding securities laws and StraightPath's existing contracts.[35] The receiver might also face serious personal tax consequences if she sought to avoid QSF status — and given how obvious QSF treatment was under the law, she was not required to preemptively seek clarification from the IRS and incur the costs and delays associated with such action.[36] In any event, the receiver's business judgment in this instance is entitled to deference from the Court, as the SEC itself acknowledges in its briefing.[37]

I have considered all objections of the Founder Defendants and other interested persons to the motion and find them unpersuasive in the context of this case. The investors' objections largely track those raised by the Founder Defendants and are unpersuasive for the same reasons. I find that the plan provides for a fair, reasonable and equitable allocation and distribution of the relevant assets. The receiver's motion (Dkt 366) is granted in all respects. The receiver is authorized to take all action deemed necessary and appropriate in her discretion to implement the terms of the Plan. The receiver may alter, amend, or modify the Plan, without further court order, one mor more times, after entry of this Order, if such alteration, amendment or modification does

35 *See* Dkt 367 at 29-30.

36 *See id.* at 26-27; Dkt 382 at 28-29.

37 *See* Dkt 381 at 6-7 (citing cases).

not materially alter the Plan. All opposition not withdrawn or resolved by this Order is overruled in all respects. The Court retains jurisdiction to hear and determine all matters arising from the implementation of this Order.

SO ORDERED.

Dated: November 26, 2024

Lewis A. Kaplan
United States District Judge