

**IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION**

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

v.

TODD ELLIOTT HITT, ET. AL.,

Defendants.

Civil No. 1:18-cv-01262

UNITED STATES OF AMERICA,

v.

TODD ELLIOTT HITT,

Defendant.

Criminal No. 1:19-cr-43

**MEMORANDUM IN SUPPORT OF MOTION TO APPROVE RECEIVER /SPECIAL
MASTER’S RECOMMENDED PLAN OF RESTITUTION AND DISTRIBUTION**

Christopher L. Perkins, the court-appointed Receiver/Special Master in the above-captioned proceedings (“**Movant**”), pursuant to this Court’s October 15, 2018 and February 23, 2019 Orders, respectfully submits the following Memorandum in Support of his Motion to Approve Recommended Plan of Restitution and Distribution (“**Motion**”).¹

¹ A copy of the Recommended Plan of Restitution and Distribution is attached as Exhibit 1.

PRELIMINARY STATEMENT

For the past fourteen months, the Receiver and his professionals have been engaged in the marshalling, preservation, and liquidation of the assets and property of the numerous estates in these proceedings. At the same time, the Receiver and his professionals have undertaken a detailed analysis of the over \$85 million in asserted claims of those individuals and companies victimized by the fraud perpetrated by Todd Elliott Hitt (“**Hitt**”). Pursuant to this Court’s directives, and in accordance with applicable federal law, the Movant has developed a plan for identification of victims and for the distribution, including restitution, to those harmed by Hitt’s conduct. As described herein, the Movant’s overlapping obligations as both Receiver and Special Master, and his activities in this case, have been designed to both maximize - while also prioritizing - recoveries to investor victims and creditors alike. If approved, the Movant’s plan will return approximately 88% of the allowed claims of investor victims, and approximately 50% of the allowed creditor claims.² Moreover, pursuant to applicable law, Hitt will remain liable for the shortfall in both classes, and will be subject to an order of restitution for the balance due to investor victims pursuant to the Mandatory Victim Rights Act (“**MVRA**”).³ The Movant submits that this plan is consistent with the MVRA as well as the orders appointing him, is fair and reasonable, is in the best interests of the receivership, and should be approved in order to provide prompt restitution and distributions to all claimants.

² Precise amounts are subject to final determination following the liquidation of the remaining few assets and reconciliation and payment of estate administrative expenses and tax liabilities.

³ Additionally, creditors retain the right to pursue Hitt for any deficiency not paid on their Claims under the Movant’s Plan.

Procedural and Factual Background

Civil Case Proceedings

1. On October 5, 2018, the Securities and Exchange Commission (“SEC”) commenced the civil case by filing a Complaint for securities fraud against Hitt individually, and against Kiddar Capital LLC (“Kiddar Capital”) and Kiddar Group Holdings, Inc. (“Kiddar Holdings”), as corporate defendants, for violations of federal securities laws. Among the entities named as Relief Defendants were Kiddar Herndon Station, LLC (“Herndon Station”)⁴. Kiddar Homebuilding Fund I, LLC (“Homebuilding Fund”), Melbourne Retreat LLC (“Melbourne”), Kiddar Mass Ave LLC (“Mass Ave”), Kiddar Ridgeview LLC (“Ridgeview”), ESA Emerson LLC (“Emerson”), ESA Highwood LLC (“Highwood”), and Kiddar AQ, LLC a/k/a Kiddar Aquicore LLC (“Aquicore”).

2. By Order dated October 12, 2018, this Court appointed Bruce H. Matson as Receiver in the civil case (the “Receivership Order”) establishing the estates of the various defendants (“Receivership Estates”) and vesting the Receiver with certain general powers and duties.⁵

3. More specifically, the Receivership Order provides, in pertinent part, that the Receiver shall have the following powers:

- 5(c) to manage, control, operate and maintain the Receivership Defendants and hold in the Receiver’s possession, custody and control all Receivership Property, pending further Order

⁴ Herndon Station initially opposed its status as a Relief Defendant but, as described herein, later consented to such designation in connection with a settlement with the Receiver.

⁵ By Order dated December 13, 2019, Movant was appointed Receiver to succeed Mr. Matson.

of this Court;

5(j) to market and sell the real properties belonging to Defendant Todd Elliott Hitt (“Hitt”) located at 2901 North Kensington, Arlington, VA and 2940 Penny Lane, Fairfax, VA, and collect and use the proceeds for payment toward the disgorgement and prejudgment interest Hitt owes in his matter and/or to distribute to injured investors as part of the receivership;

Receivership Order, paragraphs 5(c) and (j) (emphasis added) (Civil Docket No. 21).

4. During the course of his investigation in the civil proceeding, the Receiver concluded that Hitt’s extensive commingling of investments between and among numerous corporate entities resulted in an amalgamation of ventures that were hopelessly intertwined, such that the most efficient and best course of action for victims was to consider the corporate Defendants and Relief Defendants as one combined estate. Further, this complex web of fraud reached beyond the Relief Defendants and extended into assets tangentially implicated in the Receivership. Even more challenging, the Receiver determined that many victims had “invested” in multiple opportunities, some of which were within, and others outside of, the Receivership. Based on the foregoing, and rather than expend resources attempting to untangle the fraud, it was the Receiver’s intention to consolidate funds and claims, but to prioritize certain claims over others within the confines of the orders appointing him and applicable law.

5. Pursuant to the Receivership Order, the Receiver liquidated all of the real property and the majority of the personal property of the Receivership Estates.⁶ By Order dated November 16, 2018, the Court approved the Receiver’s Motion Establishing Procedures for the

⁶ A few items of personal property are still in the process of liquidation. The Movant anticipates concluding such sales by March 1, 2020.

sales of real property. (Civil Docket No. 39). Between February and August 2019, the Receiver consummated eight separate real property sales (including sales of the two Hitt-owned properties), and after satisfaction of secured claims against those properties, received approximately \$400,000 in net proceeds.

6. By Order dated December 14, 2018, this Court approved the Receiver's Motion To Establish A Claims Bar Date, Approve the Manner And Form Of Notice Of Claims Bar Date And Approve The Process for Submitting Claims ("**Bar Date Order**"). (Civil Docket No. 42). The Bar Date Order established January 28, 2019 ("**Bar Date**") as the last day by which claimants must file claims against the Receivership Estates. As a result, a total of 132 claims were filed by individuals and entities claiming to be investor victims and creditors.

Criminal Case Proceedings

7. On October 4, 2018, the United States commenced a criminal case by filing a Complaint for securities fraud against Hitt.

8. On February 13, 2019, Hitt entered into a Plea Agreement with the United States wherein he recognized restitution to the victims of his crimes was mandatory pursuant to applicable criminal statutes, and acknowledged an anticipated future payment on his behalf of approximately \$20 million towards that restitution.⁷ (Criminal Docket No. 24). The Plea Agreement implicitly acknowledged the potential for a shortfall in payment of such restitution, noting that Hitt "shall pay the balance on any remaining court-ordered restitution, if any, in monthly installments to be determined by the court." (Criminal Docket. No. 24 at ¶4(c)).

⁷ At the time of the Plea Agreement, the Receiver was heavily involved in negotiations with the Hitt Family, ultimately resulting in a settlement and substantial payment to the Receiver, as described more fully herein.

9. By Order that same day, this Court appointed the Receiver as Special Master in the criminal case (**“Special Master Order”**). The Special Master Order provides that the Movant’s general powers and duties under the Receivership Order are extended to include other Hitt-related investments as well as Hitt’s personal property (thus bringing within the Receiver’s control, those assets implicated in Hitt’s fraud but outside the Receivership). Further, the Special Master Order directs the Special Master to fashion a proposed restitution order consistent with applicable criminal statutes, and recommend findings to the Court on the following issues: (a) which entities and individuals are properly considered “victims”; (b) the proper amount of restitution owed to each such victim; and (c) an appropriate payments schedule. (Criminal Docket No. 28).

10. The Special Master Order also noted that the responsibilities and powers of the Special Master were “intended to complement and work in harmony” with the powers and duties under the Receivership Order. In other words, given the substantial overlap between the two proceedings, but also recognizing the existence of separate duties as both a Receiver and Special Master, the Receiver was granted some flexibility to craft a recommended distribution and restitution plan.

Receiver/Special Master Settlements

11. In furtherance of his strategy, the Receiver immediately embarked on discussions and negotiations with the key constituents in the proceedings including the Hitt Family, and the largest investor victims (with respect to assets both inside and outside of the Receivership). As a result, the Receiver successfully resolved the bulk of the investor claims through a series of three complementary settlement agreements designed to work in unison with each other.

12. First, the Receiver intervened in, and pursued certain claims of the Receivership Estates related to Herndon Station. As a result, Herndon Station agreed to the entry of a Consent Order dated February 8, 2019, wherein the Court took exclusive jurisdiction of Herndon Station's assets for the limited purpose of entertaining a consent motion to approve a settlement ("Herndon Settlement") among Herndon Station, certain investor victims, and the Hitt Family ("Hitt Family"). (Civil Docket No. 58).

13. By Order dated March 8, 2019, the Court approved the Herndon Settlement which, among other things, substantially reduced both the number and dollar amount of the claims against the Receivership Estates by: (i) permitting restitution payments by the Hitt Family directly to certain investor victims,⁸ and (ii) permitting assumption of certain liabilities by the Herndon Station investors in exchange for control of the Herndon Station assets. (Civil Docket No. 75).

14. Second, by Order dated June 12, 2019, and as contemplated in the Plea Agreement, the Court approved a settlement between the Hitt Family and the Receiver ("Hitt Family Settlement") resulting in value to the estates of \$20 million.⁹ (Civil Docket No. 101).

15. Notably, within the Settlement Agreement the Hitt Family noted its "objective" to:

provide the Receiver/Special Master with a specific amount of money to provide economic relief to those who were injured by [Hitt]'s conduct as alleged in the Civil Action and the Criminal Case. To that end, [the Hitt Family] is willing to provide a fund

⁸ Those restitution payments were \$932,000 to Herndon Station, \$1.2 million to Woodfield Investment Company, and \$1.6 million to VR Investments.

⁹ The value of \$20 million included payments made directly by the Hitt Family to investors both pursuant to the Herndon Settlement, and prior to the filing of these actions. The total payment to the Receiver after credit for those payments, was \$13,714,101.

for purposes of providing restitution for parties that are deemed as victims in the criminal Case, and thus legally entitled to restitution in that case, as well as victims and creditors deemed entitled to compensation by the Receiver in the Civil Action.

(Civil Docket. No. 101, Exhibit A at ¶F).

16. Thus, the Hitt Family Settlement was consistent with the Receiver's broader intentions in these dual proceedings that all parties harmed by Hitt's conduct share in the recovery, augmented by funds provided by the Hitt Family. The Hitt Family Settlement recognized that the Special Master would "make recommendations" with respect to both the "amount" and "usage of the Settlement Fund to make payment" in respect of claims of "persons harmed as a result of [Hitt]'s conduct in the Criminal Case and the Civil Action." *Id.* at ¶2.

17. While based on significant analysis shared between the Receiver and the Hitt Family, the ultimate dollar amount of the Hitt Family Settlement represented an approximation of the anticipated total of all valid claims against the estates after objections, as well as reductions obtained by the Herndon Settlement and the future anticipated settlement with the larger investors.

18. The Hitt Family settlement incorporated the terms of the Herndon Settlement (as it relates to the Hitt Family payments in that prior agreement), and also contemplated a subsequent settlement among the Receiver and the larger investor victims involving several of the assets outside the Receivership, such as Broad & Washington, LLC, and 300 West Broad Street, LLC (Motor Lodge). The Hitt Family Settlement acknowledged that "[i]n connection herewith, the Special Master may seek Court approval of separate and further agreements with the parties, creditors, and/or investors" of those entities to satisfy the claims related to such entities. *Id.* at ¶6.

19. **Third**, as further detailed herein and in the Recommended Plan, the Receiver recently concluded negotiations with ten of the major investors in various other Hitt-related investments including the Broad & Washington, Motor Lodge, Church Road, and Kiddar Triangle commercial properties, as well as the Kiddar Aquicore and WishWould investments (**“Supplemental Settlement”**). The Supplemental Settlement was designed in the same manner and with same objectives as the Herndon Settlement (reduction and allowance of claims in exchange for transfer of certain assets and assumption of liabilities), and as contemplated in the Hitt Family Settlement. A copy of the Supplemental Settlement Agreement, as amended, is attached as Exhibit 2.

Claims Analysis and Reconciliation

20. A total of 132 claims were submitted prior to the Original Bar Date with a total claimed amount in excess of \$144,000,000.

21. The Receiver and his professionals carefully reviewed and analyzed the submitted claims, compared them to the books and records of Hitt and the Receivership Entities, engaged in discussions with numerous claimants and counsel, and determined a recommended Allowed Amount for each claim. Claims were reduced or disallowed for several reasons, including: (i) the applicable terms of the Herndon, Hitt Family and Supplemental Settlements; (ii) reductions due to improperly sought profits or interest payments, (iii) filing of duplicative claims, and/or (iv) claims submitted for amounts either not owed by a Receivership Entity or for which the claimed amount was inadequately documented. A schedule of allowed and disallowed claims (the **“Claims Schedule”**) has been filed as Exhibit A to the Plan. The Movant also assigned claims to classes, as discussed below and detailed in the Claims Schedule.

22. To the extent a claimant disagrees with the proposed treatment of a claim, and the Movant and claimant are unable to reach a consensual resolution, the Movant will seek the assistance of this Court to adjudicate any outstanding claim disputes.

23. Having now completed the claims analysis, and assuming the approval of the Supplemental Settlement and the Recommended Plan, the Receiver will achieve a reduction in the total claims pool from \$144 million to approximately \$22.2 million. Of that number, \$19,102,925 represents Class 1 investor victim claims and \$3,170,088 represents Class 2 creditor claims.

Overview of the Recommended Distribution Plan

24. Immediately following the Receiver's appointment in October 2018, the Receivership Entities had approximately \$4.8 million in cash on hand; today the Receiver possesses in excess of \$20 million in cash resulting from the Receiver's ongoing efforts.

25. The assets and liabilities of the Receivership Entities and Hitt's personal property have been consolidated for the purpose of making distributions. Funds available for distribution under the Plan will be distributed from the Receiver's account, containing the accumulation of proceeds from the various settlements brokered by the Receiver, and from the real and personal property sales and miscellaneous recoveries. The Movant consulted extensively with various stakeholders (including the SEC, the Department of Justice, and certain representative claimants) and obtained their perspectives prior to filing the Plan and Motion.

26. The Receivership Order authorizes the payment of reasonable compensation and expense reimbursement from the funds in the Receivership Estates to the Receiver and his professionals, who have obtained approval of this Court for interim compensation in these

proceedings. The Receiver and his professionals intend to submit Final Applications per the terms of the Receivership Order, which funds will be paid prior to the final distribution under the Plan.

27. After payment of administrative expenses and tax liabilities of the Receivership Estates, the recommended Plan divides the funds held by the Receiver into two distinct “pools”:

Pool 1: Criminal Restitution Funds:

- Funds obtained from the Hitt Family pursuant to the Hitt Family Settlement;
- Proceeds from the sale of the two Hitt-owned parcels of real property; and
- Proceeds from the sale of various personal property of Hitt including limited partnership investments and jewelry.

Pool 2: Receivership Funds:

- Funds obtained at the outset of the Receivership from various bank accounts of the Relief Defendants;
- Proceeds from the sale of the six Relief Defendants-owned parcels of real property; and
- Miscellaneous recoveries.

28. Further, the recommended Plan prioritizes restitution to investor victims and divides Allowed Claims into two categories (“Classes”) for distribution purposes:

Class 1: Investor Victim Claims:

- Claims by individuals or entities that deposited or invested money, securities or other financial instruments with Hitt and/or one or more Receivership Entities; and
- The claim of An Ping Corporation related to the investment in 300 West Broad Street, Falls Church, Virginia (Motor Lodge).

Class 2: Creditor Claims:

- Claims of employees of Kiddar Capital for unpaid wages;
- Claims of vendors, independent contractors, trade creditors, or other general unsecured creditors for fees, reimbursable expenses, goods, or services provided to one or more Receivership Entities;
- The claim of Eagle Bank for the deficiency on the sale of the real property located at 3414 N. Emerson Street, Arlington, Virginia; and
- The unsecured claims of investors for goods or services provided to Hitt and/or one or more of the Receivership Entities that were unrelated to such investor's criminal restitution claim.

29. The Movant proposes to make Distributions as follows: Class 1 shall share *pro rata* from the funds in Pool 1. Any deficiency owed to Class 1 after distribution from Pool 1, will be added to, and share *pro rata* with, Class 2 from the funds in Pool 2. In this fashion, it is anticipated that Class 1 will receive a total of approximately 88% of their Allowed Claims, and Class 2 will receive approximately 50% of their Allowed Claims.

30. In addition, the Plan provides that Hitt will remain liable for, and shall be ordered to pay as restitution, the anticipated deficiency to allowed Class 1 Claims. Such sum shall be paid by Hitt in monthly installments until paid in full.

31. The Movant is simultaneously requesting approval of the Plan and authorization to make Distributions. Within 30 days of approval of the Plan, the Movant proposes to make Distributions to Class 1 from Pool 1, resulting in partial satisfaction of the Allowed Amount of all Investor Victims Claims, and reserving Pool 2 to complete the final administration of the Receivership Estates and pay Allowed Administrative Claims

and tax liabilities, if any. Thereafter, a second and final Distribution will be made to Class 2 from Pool 2, as the remaining funds in the estate will permit.¹⁰

32. Approval of the Plan constitutes a final settlement of various issues including the nature and characterization of intercompany transactions, the consolidation of the assets and liabilities of the Receivership Entities, while preserving the SEC's right to continue to pursue and/or bring new legal actions at its discretion.

33. Additionally, the Plan provides for a discharge of the Receivership Entities from all claims and liabilities arising on or before the date the Plan becomes effective (other than those liabilities created by the Plan) and a release of the Receiver, his advisors and other professionals retained by the Receiver, as well as the Hitt Family, relating to the Receivership Entities, the Plan, or the general administration of the Receivership Estate. The Plan does not provide a release for Hitt.

ARGUMENT

A. The Supplemental Settlement Should Be Approved.

34. Shortly after his appointment, the Movant began negotiations with numerous parties regarding their investments in and claims against both the Receivership Estates and the other Hitt-related investments referred to in the Special Master Order. After investigation and analysis, the Receiver negotiated a series of three settlements designed to reduce the overall claims pool, dispose of assets, and fix the amount of allowed claims.

¹⁰ To the extent the final administration of the estates will exceed five months after approval of the Plan, the Movant reserves the right to make a Second Interim Distribution.

35. Following the entry of the orders approving the (i) Herndon Station and (ii) Hitt Family Settlements, the Receiver engaged in further discussions with certain investors (the “Supplemental Settlement Investors”)¹¹ regarding restitution to them of their victim claims, as well as the resolution of related issues impacting the Receivership Estates. After intensive discussion and careful consideration, the parties reached an agreement embodied in the Supplemental Settlement Agreement attached hereto as Exhibit 2 (“Supplemental Settlement Agreement”).

36. The Supplemental Settlement Agreement: (i) disposes of and maximizes the value of certain assets within the purview of the Receivership and Special Master Orders; (ii) fixes the Allowed Amount of many of the largest investor victim restitution amounts; and (iii) and paves the way for the Distributions and related provisions of this Plan.¹²

37. In summary, the proposed settlement provides as follows:

- Resolution of all claims involving Broad & Washington, LLC, including the disposition of the associated real estate and a cash payment to the Receiver of \$550,000;
- Resolution of all claims involving 300 West Broad Street, LLC, including the disposition of the associated real estate;
- Resolution of all claims involving Kiddar AQ, LLC a/k/a Kiddar Aquicore, LLC, including the disposition of the associated investment interests;
- Resolution of all claims involving investment in WishWould, including the disposition of the associated investment interests;

¹¹ Many of the Supplemental Settlement Investors were also investors in Herndon Station.

¹² By agreement, and following the initial execution of the Supplemental Settlement Agreement, certain investors' claims were adjusted after consultation with the SEC, thus resulting in the Amendment to the Supplemental Settlement Agreement. Such adjustments moved certain aspects of an investor victim claim into Class 2. Further, while the original Supplemental Settlement Agreement contemplated a “stand-alone” motion to approve a priority scheme of payments, that concept has been incorporated into the Plan and Motion, and has been adjusted by the Movant with respect to the claim of An Ping Corporation.

- Resolution of all claims involving HCM-Church Road, LLC, including the disposition of the associated investment interests;
- Resolution of all claims involving Kiddar Triangle, LLC including the disposition of the associated real estate;
- Resolution of various investor and creditor claims asserted by Matthew Bullock, Glenn Ferguson, Richard Hausler, David Mark, Robert Rucks; An Ping Corporation, Christopher David, William Quinby; and Brian Casey in agreed amounts; and
- The exchange of mutual releases.¹³

38. The well-established law encourages the approval of settlements to help resolve proceedings involving the administration of estates. For example, in *Meyers v. Martin (In re Martin)*, 91 F.3d 389 (3d Cir. 1996), the United States Court of Appeals for the Third Circuit noted that “[t]o minimize litigation and expedite the administration of a bankruptcy estate, compromises are favored . . .” *Id.* at 393, *see also Shaia v. Three Rivers Wood, Inc. (In re Three Rivers Wood, Inc.)*, Nos. 98-38685-T, 99-3020-T, 2001 WL 720620, at *5 (Bankr. E.D. Va. Mar. 20, 2001) (“Not surprisingly, compromises are favored in bankruptcy courts.”); *In re Frye*, 216 B.R. 166, 170 (Bankr. E.D. Va. 1997) (“Bankruptcy Rule 9019 governs compromise of a claim and permits a trustee to compromise or settle controversies to avoid the time and expense of litigating controversial claims.”).

39. In determining whether to approve a compromise, the Court must look at various factors and determine whether the compromise is in the best interests of the estate and whether it is fair and equitable to the creditors of the estate. *Frye*, 216 B.R. at 174. These factors include: (1) the probability of success in litigation; (2) the potential difficulties, if any, in collection; (3)

¹³ Consistent with the terms of the Herndon and Hitt Family Settlements, there is no release of Todd Hitt individually.

the complexity of the litigation involved in the expense, inconveniences and delays necessarily attending it; and (4) the paramount interest of the creditors. *Id.*; *see also Three Rivers Wood*, 2001 WL 720620, at *6 (citing *In re Austin*, 186 B.R. 397, 400 (Bankr. E.D. Va. 1995)).

40. Applying these factors, the Movant concluded that the Supplemental Settlement Agreement is in the best interests of all the Receivership Estates and the investor victims considering, among other things; the ability, time, and expense to liquidate estate assets; the substantial reduction to claims achieved by the settlement; and the attendant cost and risk in litigating such claims. Further, the Supplemental Settlement paves the way for the Receiver's proposed Distributions and final administration of these estates, as detailed in the Plan.

41. In light of the above considerations, the Court should approve the proposed settlement as reasonable, fair and equitable, as determined by an informed, independent judgment. *See Martin v. Kane (In re A & C Properties)*, 784 F.3d 1377 (9th Cir. 1986); *Drexel, Burham, Lambert, Inc. v. Flight Transportation Corp. (In re Flight Transp. Corp. Sec. Litig.)*, 730 F.2d 1128 (8th Cir. 1984); *American Can Co. v. Herpel (In re Jackson Brewing Co.)*, 624 F.2d 605 (5th Cir. 1980).

B. The Recommended Plan Is Fair and Reasonable and Should Be Approved

42. The Movant's Recommended Plan is designed to compensate all victims of the fraud perpetrated by Hitt. The Movant submits that the Recommended Plan is fair and reasonable, is in the best interests of the Receivership Estates, and thus should be approved by this Court. As described below, the Plan's methodology is similar to those used in other receiverships and is consistent with applicable law and the Receivership and Special Master Orders.

43. Federal district courts have broad discretion in fashioning relief in equity receiverships. *See SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 91 (2d Cir. 2002); *SEC v. Basic Energy & Affiliated Res., Inc.*, 273 F.3d 657, 668 (6th Cir. 2001); *SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 328 (5th Cir. 2001); *SEC v. Elliott*, 953 F.2d 1560, 1566-67 (11th Cir. 1992); *SEC v. Hardy*, 803 F.2d 1034, 1037-39 (9th Cir. 1986). Pursuant to these broad powers, courts may authorize any distribution of receivership assets that is “fair and reasonable.” *SEC v. Wealth Mgmt. LLC*, 628 F.3d 323, 332-33 (7th Cir. 2010); *SEC v. Wang*, 944 F.2d 80, 85 (2d Cir. 1991); *SEC v. Byers*, 637 F. Supp. 2d 166, 174 (S.D.N.Y. 2009) (quoting *Wang*, 944 F.2d at 81). So long as a court divides the assets “in a logical way,” the court’s distribution will not be disturbed on appeal. *United States v. Durham*, 86 F.3d 70, 73 (5th Cir. 1996). Appellate review of distribution orders is “narrow,” *Forex*, 242 F.3d at 331 (quotation omitted), as appellate courts must not “chain the hands of the court in Equity” nor “rob the lower court of the discretion essential to its function.” *Durham*, 86 F.3d at 73.

44. Here, the recommended Plan strikes an appropriate balance between the Movant’s duties as Receiver and those as Special Master, while simultaneously prioritizing claims and funds based on the nature of the claims and assets. Consistent with the Plea Agreement, and the orders appointing the Movant, the Plan distributes the Hitt Family settlement funds and proceeds from Hitt’s personal property *solely* to investor victims. The Plan also provides for a prompt, substantial initial Distribution to those investor victims. At the same time, the Plan also achieves the parties’ goals of providing some recovery to all claimants through the application of other estate funds. And, the Plan preserves and dictates the terms of Hitt’s personal liability for any deficiency and future restitution obligations.

1. Consolidation of Assets and Liabilities Is Appropriate.

45. The Plan treats the assets and liabilities of the Receivership Entities on a consolidated basis without consideration of the assets and liabilities of individual Receivership Entities, provides for the pro rata distribution of assets to similarly situated claimants and is consistent with the orders appointing the Movant, the Plea Agreement, and the MVRA. As discussed below, there is ample authority for all of these approaches.

46. Specifically, for purposes of distribution in an equity receivership, courts may ignore the separate identities of entities that are part of “a unified scheme to defraud.” *Byers*, 637 F. Supp. 2d at 180-81; *see also CFTC v. Topworth Intern., Ltd.*, 205 F.3d 1107, 1110-11 (9th Cir. 1999) (treating entities as one fund because “each entity appeared to be the alter ego of the other”); *SEC v. Sunwest Mgmt., Inc.*, CIV. No. 09-6056-HO, 2009 WL 3245879 (D. Or. Oct. 2, 2009)(receivership entities considered “unitary enterprise” for distribution purposes due to extensive commingling of funds); *AmeriFirst*, 2008 WL 919546, at *4 (“a pooled distribution is equitable when the separate legal entities were involved in a unified scheme to defraud”); *Eustace*, 2008 WL 471574, at *7-8 (pooling assets for distribution due to evidence of commingling and joint marketing among entities); *Quilling v. Trade Partners Inc.*, No. 1:03-CV-236, 2007 WL 107669, at *2 (W.D. Mich. Jan. 9, 2007); *see also Forex*, 242 F.3d at 331 (affirming plan adopted by district court pooling assets of entities for distribution); *U.S. v. Durham*, 86 F.3d 70, 71-73 (5th Cir. 1996) (same).

47. Consolidation is particularly appropriate in this case where Hitt disregarded corporate formalities and commingled funds between and among the Receivership Entities. Further, any attempt to segregate the assets and liabilities of the Receivership Entities would be

costly and time-consuming. Consolidation in this equity receivership is practical and, given Hitt's actions, is the only equitable method in which assets can be distributed. Thus, the Court should exercise its equitable powers to approve this "fair and reasonable" approach. *See Wealth Mgmt.*, 628 F.3d at 332-33; *see also AmeriFirst*, 2008 WL 919546, at *4 (corporate form may be disregarded for distribution purposes so long as "an equitable basis" exists).

2. The Priority Scheme of Distributions is Appropriate.

48. The Movant proposes that the Court authorize the following process by which all Receivership Claims will be paid, including the establishment of the following: (i) claims allowance principles; and (ii) categories and priorities of claims that will be paid from the funds recovered in the Receivership estates:

- a. Due to the confusion and incompleteness of documentation and the Defendants' failure to maintain consistent corporate formalities, the Receiver will treat all claims as claims against a single, combined receivership estate.
- b. No Receivership Claim will be paid unless it becomes an "Allowed Claim" in a fixed sum as provided in one or more orders of the Court.
- c. The Receiver has recommended to the Court the Allowed amount he believes to be the proper "legal obligation of the Receivership Defendants" and/or the recommended "restitution amount" for any victims as contemplated by the Special Master Order.
- d. As a general matter, all Allowed Claims will be limited to the principal amount of the claim and shall not include interest, costs, attorneys' fees, lost profits or any other additional or supplemental damages.
- e. Each "Allowed Claim" shall be designated as a claim in one of the following categories:
 - i. Allowed Administrative Claim;
 - ii. Allowed Investor Victim Claim (Class 1);
 - iii. Allowed Creditor Claim (Class 2).

- f. From the two pools of funds available to the Receiver, and after payment of administrative expenses and tax liabilities, the Receiver shall pay the Allowed Claims *pro rata* within each class of claims.

49. The Court’s power to approve the Receiver’s claim determinations and priority of claims is well-settled. *See Elliott*, 953 F.2d at 1566. This power includes the exercise of the Court’s equitable powers to subordinate claims. *See, e.g., SEC v. Ariz. Fuels Corp.*, 739 F.2d 455, 459 (9th Cir. 1984) (“Receivership courts have the general power to use summary procedures in allowing, disallowing, or subordinating the claims of creditors.”); *In re Westgate Cal. Corp.*, 642 F.2d 1174, 1177 (9th Cir. 1981) (“Subordination is an equitable power and is therefore governed by equitable principles.”).

50. It is not surprising that, in equity receiverships, courts approve of treating similarly- situated claimants equally. *See Wealth Mgmt.*, 628 F.3d at 333; *SEC v. Infinity Grp. Co.*, 226 F. App’x 217, 218 (3d Cir. 2007); *SEC v. Capital Consultants, LLC*, 397 F.3d 733, 737, 746-47 (9th Cir. 2005); *Credit Bancorp*, 290 F.3d at 87-89; *Forex*, 242 F.3d at 331-32; *Elliott*, 953 F.2d at 1569-70; *Byers*, 637 F. Supp. 2d at 176. “Courts have favored *pro rata* distribution of assets where . . . the funds of the defrauded victims were commingled and where victims were similarly situated with respect to their relationship to the defrauders.” *Credit Bancorp*, 290 F.3d at 88-89. Pro rata distribution is “especially appropriate for fraud victims of a ‘Ponzi scheme.’” *Id.* at 89. The methodology in the proposed Plan, which provides for a pro rata distribution to claimants who are similarly situated, is consistent with this approach.

51. The Receiver’s method for calculating losses and thus Allowed Claims is also consistent with relevant authority. Courts routinely order that pro rata distribution be based on

claimants' net losses. A claimant's net loss equals the amount of consideration paid into the scheme by the claimant minus the total amount paid to the claimant. *See Capital Consultants*, 397 F.3d at 737; *CFTC v. Capitalstreet Fin., LLC*, 2010 WL 2572349 at *3 (W.D.N.C. June 18, 2010). Pro rata distribution based on net loss is equitable because it ensures that all investors who suffered an out-of-pocket loss receive compensation from the Receivership. *See CFTC v. Barki*, 2009 WL 3839389, at *1-2 (W.D.N.C. Nov. 12, 2009) (favoring net loss method because it compensates large percentage of defrauded investors); *see also Byers*, 637 F. Supp. 2d at 182 (same). It also ensures that compensation is proportional to the size of investors' losses.

3. An Initial Priority Restitution Distribution to Allowed Claims of Investor Victims is Appropriate.

52. The Special Master Order directs the Special Master to “fashion a proposed restitution order and recommend findings to the Court on the following issues: (a) which entities and individuals are properly considered “victims” pursuant to 18 U.S.C. § 3663A(a)(2); (b) the proper amount of restitution owed to each victim pursuant to 18 U.S.C. §§ 3663A(b) and 3664(e); and (c) an appropriate payment schedule pursuant to, among other sections, 18 U.S.C. § 3664(i); as well as other issues that may arise under 18 U.S.C. §§ 3663, 3663A, or 3664, and as may be ordered by the Court.

53. A victim is one that is “directly harmed by the defendant’s criminal conduct.” *United States v. Blake*, 81 F.3d 498, 506 (4th Cir. 1996). The act that harms the potential victim must consist of “conduct underlying an element of the offense of the conviction” or one “taken in furtherance of a scheme, conspiracy or pattern of criminal activity that . . . is an element of the offense . . .” 81 F.3d 498, 506 (4th Cir. 1996). The elements of securities fraud include: (1) misrepresentation or omission; (2) of material fact; (3) made with scienter; (4) justifiably relied

on by plaintiffs' and (5) which proximately caused the plaintiffs' injury. *Bovee v. Coopers & Lybrand*, 216 F.R.D. 596 (S.D. Ohio 2003). The victim's losses must be a significant part of the greater fraud for which the defendant was convicted. *United States v. Skowron*, 839 F. Supp. 2d 740, 744 (S.D.N.Y. 2012), *aff'd*, 529 F. App'x 71 (2d Cir. 2013).

54. Here, based on his analysis of the claims, the Receivership records, and extensive discussions with claimants, counsel and Hitt, the Movant has classified certain claimants as victims and has recommended an initial distribution as restitution on those victims' Allowed Claims from Pool 1, while reserving Pool 2 for final administrative expenses, and tax liabilities preceding a final distribution.

55. District courts frequently order interim or preliminary distributions. *See, e.g., Credit Bancorp*, 290 F.3d at 85; *SEC v. Black*, 163 F.3d 188, 193 (3d Cir. 1998); *CFTC v. PrivateFX Global One*, 778 F. Supp. 2d 775, 778 (S.D. Tex. 2011); *SEC v. AmeriFirst Funding, Inc.*, No. 3:08-CV-1188-D, 2008 WL 919546 (N.D. Tex. Mar. 13, 2008); *CFTC v. Eustace*, No. 05-2973, 2008 WL 471574, at *7 (E.D. Pa. Feb. 19, 2008); *SEC v. Merrill Scott & Assocs., Ltd.*, No. 2:02-CV-39, 2006 WL 3813320, at *1 (D. Utah Dec. 26, 2006). The Movant submits an initial Distribution is appropriate in this case.

NOTICE

56. The Movant will file an affidavit of service reflecting that he has provided notice of the Motion, Memorandum of Support, and Plan as follows:

- *Notice by Electronic Mail and Regular Mail.* The Receiver will serve this Motion on all known claimants and their counsel by electronic mail, and by regular mail (to the extent both addresses are known).

- *Notice by Publication.* The Receiver will also publish notice on his dedicated receivership website maintained by American Legal Claims.
- *Notice upon Inquiry.* Finally, the Receiver proposes to promptly provide a copy of this Motion to any claimant who makes a written request for such documents to the Receiver, the Receiver's legal counsel or the Receiver's electronic mail address: Kiddar@americanlegal.com, or physical addresses.

57. The Receiver will set this Motion for a hearing three weeks after the filing of the Motion so as to give potential claimants sufficient notice of the relief sought herein.

WHEREFORE, for the reasons stated herein, the Movant respectfully requests that the Court enter an Order substantially in the form attached as Exhibit 3, approving the Supplemental Settlement and the Recommended Plan of Distribution, and such other relief as is appropriate.

Dated: January 17, 2020

CHRISTOPHER L. PERKINS,
RECEIVER/SPECIAL MASTER

/s/

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CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of January 2020, a true and correct copy of the foregoing was filed with the Court through the Clerk's CM/ECF filing system and served on all persons receiving electronic notice in this case, and/or by first-class mail, postage prepaid, to all parties listed below:

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