UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

FRANCISCO ILLARRAMENDI, HIGHVIEW POINT PARTNERS, LLC and MICHAEL KENWOOD CAPITAL MANAGEMENT, LLC,

Defendants,

and

HIGHVIEW POINT MASTER FUND, LTD., HIGHVIEW POINT OFFSHORE, LTD., HIGHVIEW POINT LP, MICHAEL KENWOOD ASSET MANAGEMENT, LLC, MK ENERGY AND INFRASTRUCTURE, LLC, and MKEI SOLAR, LP,

Relief Defendants.

11-CV-00078 (JBA)

ECF CASE

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John J. Carney, Esq. (the "Receiver"), as Receiver for the Michael Kenwood Group, LLC (the "MK Group"), Highview Point Partners, LLC ("HVP Partners") and certain affiliated entities[1] in the above captioned matter, by and through his undersigned counsel respectfully moves pursuant to paragraphs 14 and 47 of the January 4, 2012 Amended Order Appointing Receiver (Doc. No. 423) (the "Amended Order") for an order expanding the Receivership to include Highview Point Master Fund, Ltd. ("Master Fund"), Highview Point Offshore Fund, Ltd. ("HVP Offshore") and Highview Point LP ("HVP LP") (collectively, the "HVP Funds") (the "Motion"). The relief requested is necessary and appropriate because the Receiver's ongoing investigation has confirmed that: (1) Defendant Francisco Illarramendi ("Illarramendi") operated one overarching unitary fraudulent investment scheme (the "Fraudulent Scheme" or "Fraud") that began at the Offshore Fund and later extended to and encompassed, among others, the other HVP Funds, the MK Funds[2], and certain MK Entities, and utilized their bank accounts and other entities to conceal investor losses and defraud investors; (2) Illarramendi used HVP Partners and other entities to engage in massive and pervasive commingling of investor funds held by or for

[1] To date, the following entities have been placed into the Receivership: MK Group; Michael Kenwood Capital Management, LLC; Michael Kenwood Asset Management, LLC; MK Energy and Infrastructure, LLC; MKEI Solar, LP; MK Automotive, LLC; MK Technology, LLC; Michael Kenwood Consulting, LLC; MK International Advisory Services, LLC; MKG-Atlantic Investment, LLC; Michael Kenwood Nuclear Energy, LLC; MyTcart, LLC; TUOL, LLC; MKCM Merger Sub, LLC; MK Special Opportunity Fund; MK Venezuela, Ltd.; Short Term Liquidity Fund, I, Ltd.; Highview Point Partners, LLC; MK Master Investments LP; MK Investments, Ltd., and MK Oil Ventures LLC (collectively, "the Receivership").

[2] The term "MK Funds" as used herein refers to the following: MK Special Opportunity Fund ("MK SOF"); MK Venezuela, Ltd. ("MKV") and Short Term Liquidity Fund, I, Ltd. ("STLF").

The "MK Entities" include the MK Group; Michael Kenwood Capital Management, LLC; Michael Kenwood Asset Management, LLC; MK Energy and Infrastructure, LLC; MKEI Solar, LP; MK Automotive, LLC; MK Technology, LLC; Michael Kenwood Consulting, LLC; MK International Advisory Services, LLC; MKG-Atlantic Investment, LLC; Michael Kenwood Nuclear Energy, LLC; MyTcart, LLC; TUOL, LLC; MKCM Merger Sub, LLC.

the account of the HVP Funds and MK Funds; (3) Illarramendi similarly used HVP Partners and other entities, to loot, divert and misappropriate the assets of the MK Funds and the HVP Funds; (4) at the time of the discovery of the Fraudulent Scheme, commingled proceeds of the Fraud held in the accounts of the HVP Funds were in fact largely, if not completely, derived from the MK Funds; (5) to accomplish the Fraud, Illarramendi dominated and controlled the HVP Funds and MK Funds and operated them as one collective enterprise without due regard for corporate formalities, separateness and structure or the proper segregation of corporate assets; and (6) inclusion of the HVP Funds within the Receivership properly reflects the fundamental economic reality of the Fraudulent Scheme that evolved over five years and is the only way to ensure an equitable distribution to all of Illarramendi's victims, investors and creditors alike.

For the reasons set forth below, for those provided in any further pleadings or hearings on the Motion, and based upon the Declaration of Matthew Greenblatt, submitted herewith and incorporated by reference herein (the "Declaration"), the Receiver respectfully requests that the Motion for an Order Expanding the Receivership to Include the Master Fund, HVP Offshore, and HVP LP be considered on an expedited basis and GRANTED.

PRELIMINARY STATEMENT & PROCEDURAL HISTORY

In or about December 2010, the Securities and Exchange Commission (the "Commission") commenced an onsite examination at HVP Partners which revealed numerous suspicious transactions between the HVP Funds and MK Funds. The examination led to a full investigation of the MK Funds, culminating in the above-captioned enforcement action, and the appointment of the Receiver over certain of the MK Entities. Among other duties, the Court charged the Receiver with the power to investigate, identify, marshal and preserve assets related to the fraudulent activities alleged in the Commission's initial complaint with respect to the MK Entities, and to recommend a plan for equitable distribution of such assets.

On March 7, 2011 Illarramendi pleaded guilty to a much larger fraud than was originally pleaded in the Commission's complaint. He pleaded guilty to felony violations of wire fraud (18 U.S.C. § 1343), securities fraud (15 U.S.C. §§ 78j(b) and 78ff), investment adviser fraud (15 U.S.C. §§ 80b-6 and 80b-17) and conspiracy to obstruct justice (18 U.S.C. § 371). In pleading guilty, Illarramendi admitted to operating the hedge funds he helped manage to execute an overarching, fraudulent, Ponzi-like scheme in which he "used money provided by new investors to the Funds to pay out the returns he promised to earlier investors." (Ex. B 12 of 14, *Stipulation of Offense Conduct*; Criminal Information, *United States v. Illarramendi*, 3:11 Cr. 41 (SRU)).[3] Illarramendi likewise admitted that in executing this Ponzi scheme he disregarded the corporate formalities of the funds he managed and "commingled the investments in each individual hedge fund with investments in the other hedge funds without regard to their structure, stated purpose or investment limitations and thus, treated all investments in the Funds as a single source to provide returns to investors." [*Id.*] Illarramendi acknowledged under oath that he began the Fraudulent Scheme in an effort to conceal from the investors and creditors the 'hole' that existed between the fund assets and liabilities, which has been estimated at exposing investors to potential losses in the "hundreds of millions of dollars." (*See* Exhibit B, Transcript of Plea Allocution, 40:12-41:6, 44:15-21.)

Following Illarramendi's guilty plea, on May 10, 2011, the Commission filed an amended complaint against him and added several parties as defendants and relief defendants. The Commission sought to expand the Receivership to include HVP Partners and the HVP Funds. The Court held a three-day hearing on the motion in May 2011 (the "May Hearing"), and heard the testimony of, among others, one of the Receiver's forensic accountants, Matthew

[3] Citations to exhibits refer to those exhibits attached to the Declaration.

Greenblatt of FTI Consulting, Inc. ("FTI"), Sofia Hussain of the Commission, and Illarramendi (collectively, the "Hearing Evidence"). Collectively, the Hearing Evidence established the following key facts: (1) Illarramendi's Fraudulent Scheme began with the concealment of trading losses at the Offshore Fund; (2) the assets of the HVP Funds, other entities, and the MK Entities were massively and pervasively commingled; (3) Illarramendi operated the HVP Funds and MK Entities without regard for corporate formalities and structure; and (4) Illarramendi expanded the Fraud that began at the HVP Funds to include the MK Funds, from which more than $180 million dollars was fraudulently transferred to the Master Fund to facilitate and conceal the overall Fraud.

Following the May Hearing, the Court expanded the Receivership to include HVP Partners in a decision dated June 16, 2011 (the "June Decision"). The Court also ordered the repatriation of more than $228 million held by the HVP Funds. In doing so the Court implicitly found that significant commingling of assets had occurred at the HVP Funds:

> The Commission has preliminarily shown that the Highview Funds likely do not have a legitimate claim to $180 million transferred to them from MK entities as part of Illarramendi's financial manipulation. The Commission's evidence demonstrates that the Highview Funds received assets and purported sales proceeds from MK entities for which they lacked any legitimate ownership interest, as part of Illarramendi's fraudulent management of his "pot" . . . [T]he Highview Funds did not provide any consideration for the assets that Illarramendi and HPP transferred to them from MKV and MK SOF. The Commission has therefore shown that the Funds likely lack a legitimate interest in these ill-gotten assets and are proper relief defendants in this action. (Doc #276 at 9-10.)

As demonstrated more fully below, the Hearing Evidence is more than sufficient to grant the relief requested herein. Accordingly, the Receiver respectfully submits that the Court can and should rule on the basis of Hearing Evidence and that the Receiver's Motion should be granted without any further evidentiary hearings.

Notwithstanding the sufficiency of the Hearing Evidence, and the request that the Motion be granted upon that basis, since the May Hearing, the Receiver's legal and forensic team has conducted an extensive investigation into the origin, nature and operation of the Fraudulent Scheme, including, among other things, the depositions of HVP Partners principals Francisco "Frank" Lopez ("Lopez"), Christopher Luth ("Luth"), and HVP Partners Chief Financial Officer ("CFO") and Chief Compliance Officer, Victor Chong ("Chong"). Each of them refused to testify, asserting their Fifth Amendment rights not to incriminate themselves. Even without their potentially incriminating testimony, the Receiver's forensic investigation has revealed a staggering amount of additional evidence[4] that mandates expansion of the Receivership as the proper means of achieving equity, and an equitable distribution, in this matter.

SUMMARY OF ARGUMENT

As this Court observed in its ruling on the Commission's Motion for a Temporary Restraining Order, an Order Freezing Assets, and an Order for Other Equitable Relief, "[o]nce the equity jurisdiction of the district court properly has been invoked, the Court has the power to order all equitable relief necessary under the circumstances." (Doc # 276 at 11.) *See also SEC v. Materia*, 745 F.2d 197, 200 (2d Cir. 1984). It is well-settled that upon a motion of a receiver, a district court may order entities to be consolidated or brought into an existing receivership, notwithstanding purported corporate formalities at the entities' creation. *See SEC v. Elmas Trading Corp.*, 620 F. Supp. 231, 232-241 (D. Nev. 1985) (receivership expanded to include numerous corporations where there was extensive commingling, personal use of corporate assets,

[4] This additional evidence, including that set forth in the Declaration and its exhibits, together with the Hearing Evidence, is collectively referred to herein as the "Evidence"

inadequate records, common control and shared business addresses.), *aff'd*, 805 F.2d 1039 (9th Cir. 1986); *SEC v. Byers*, 637 F. Supp. 2d 166-168 (S.D.N.Y. 2009) (commodity master-feeder hedge funds properly included within receivership over objection of commodity fund investors because commingling of funds created unified fraud and commodity fund investors were similarly situated to other investors.). This is precisely the relief that the Receiver requests here.

The primary factors that courts properly consider in determining whether entities should be brought into a receivership include: (1) the existence of one overarching fraud; (2) commingling of funds; and (3) those supporting a piercing the corporate veil/alter ego theory. In the context of a receivership established in a Commission enforcement action, a "flexible" approach should be taken in assessing the factors supporting piercing the corporate veil and bringing additional entities into the receivership, no single factor alone is dispositive. *Elmas*, 620 F. Supp. at 234. The critical factors include: (1) treatment by an individual of corporate assets as his own; (2) unauthorized diversion of funds or assets to other than corporate purposes; (3) insolvency of the entity at the time of transactions; (4) commingling of funds and other assets; (5) failure to maintain adequate corporate records; (6) diversion of assets from a corporation by or to a stockholder or other person or entity to the detriment of creditors; (7) failure to observe corporate formalities; (8) concealment and misrepresentation of personal business activities; (9) use of a corporation as a mere shell, instrumentality or conduit for a single venture or the business of an individual or another corporation; (10) common officers and directors of two entities; (11) manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another; and (12) use of the entity as a subterfuge for illegal transactions. *Elmas*, 620 F. Supp. at 233-234.

The facts here present a textbook example of the circumstances under which a receivership should be expanded to include corporate entities such as the HVP Funds. The Hearing Evidence alone clearly establishes Illarramendi's execution of one overarching Fraudulent Scheme involving the domination and control of the MK Funds and the HVP Funds and the use of their bank accounts to execute the Fraudulent Scheme; the massive commingling of investor monies in the bank accounts of the HVP Funds; and the overwhelming majority of other factors described herein. As set forth more fully below, the following additional facts further support the expansion of the Receivership to include the HVP Funds: (1) Illarramendi used HVP Partners to dominate and control the HVP Funds, and operated them without due regard for corporate formalities, structure or the proper segregation of assets; (2) Illarramendi expanded the overarching Fraudulent Scheme, which originated at the HVP Offshore Fund, to the MK Funds, from which more than a quarter of a billion dollars was fraudulently transferred to the HVP Funds; (3) Illarramendi used HVP Partners and other entities to loot, divert and misappropriate the assets of the MK Funds and the HVP Funds; (4) at the time of the discovery of the Fraudulent Scheme, the majority of remaining commingled proceeds of the Fraud were located in the accounts of the HVP Funds; and (5) it will be impossible to achieve an equitable distribution to the investor victims and creditors without the expansion of the Receivership to include the HVP Funds.

<u>FACTS IN SUPPORT OF MOTION</u>

While the Hearing Evidence itself provides a compelling basis to grant the Motion, additional facts that the Receiver's investigation has uncovered provide further overwhelming support for the expansion of the Receivership. Although a more detailed recitation of those facts is included in the Declaration, incorporated by reference herein, the following factual overview of certain facts discovered in the Receiver's investigation demonstrates that the expansion of the Receivership is proper ,and not only necessary, but indispensable to achieve equity.

From their inception, Illarramendi, Lopez, Luth, and HVP Partners operated the Funds as captive entities to raise and manage capital with minimal, if any, effective oversight. Indeed, their domination and control of the HVP Funds started even at the Funds' formation. HVP Partners was formed in 2004 and HVP Offshore was formed shortly thereafter. (*See* Decl. ¶ 6.) The HVP Partners' principals—Illarramendi, Lopez and Luth—directed the process of setting up the fund and appointing its directors. Emails show that Ogier,[5] and the U.S. law firm Seward & Kissel LLP, took direction from Luth when executing registration and making other formation decisions. (*See* Decl. ¶ 7.) Lopez was one of the five directors of HVP Offshore in May 2005, and was clearly the dominant director. Three of the other four directors were Ogier employees—essentially paid directors hired at the behest of Illarramendi and the other HVP Partners principals.

Even the execution of the investment management agreement ("Offshore IMA") between HVP Offshore and HVP Partners reflected tell-tale signs of domination and control. Lopez executed the agreement on the behalf of HVP Offshore, and Illarramendi signed it on behalf of HVP Partners. (*See* Decl. ¶ 8, Ex. D.) In essence, each party to the Offshore IMA was represented by an HVP Partner principal. This non-arm's length "negotiated" agreement ceded to HVP Partners the right and duty to make "all investment decisions for [HVP Offshore]." (Ex. D § 1.) This included buying, holding and selling securities, contracts and commodities; allocating securities, cash and other holdings; and conducting margin accounts. (*Id.*) It also

[5] The term "Ogier" as used herein refers to several related entities, including the Cayman Islands law firm Ogier & Boxalls, Ogier Nominees (Cayman) Limited, Ogier Secretaries (Cayman) Limited, and Ogier Fiduciary Services (Cayman) Limited.

included the right of HVP Partners to "enter into, make, and perform any other contracts, agreements or other undertakings" on behalf of HVP Offshore, effectively granting unfettered authority to HVP Partners to bind the HVP Funds and run their only significant business operations. (*Id.*)

Illarramendi's Fraudulent Scheme began at least as early as October 2005, as a result of a major trading loss sustained by HVP Offshore and others that Illarramendi chose to fraudulently conceal on the books of HVP Offshore.[6] (*See* Decl. ¶¶ 4, 13.) To do so, Illarramendi caused a false entry to be placed on HVP Offshore's books to fabricate a non-existent investment in Ontime Overseas, Inc. ("Ontime")[7], thereby making it appear that HVP Offshore actually received a profit from the transaction. (*See* Decl. ¶¶ 19-20.) In reality, as a result of the trading loss and cover-up, it sustained a loss of approximately $5.2 million, and from that point it was indisputably insolvent. (*See* Decl. ¶ 18.)

From the date Illarramendi began concealing losses incurred at HVP Offshore in that and in many other later transactions, he embarked on the Fraudulent Scheme that ultimately led to this proceeding and his guilty plea in federal court more than five years later. The Fraudulent Scheme involved many persons, entities and bank accounts as well as a complex web of transfers, loans and transactions among them and others that were oftentimes poorly or falsely documented, or not documented at all, on the books of the HVP Funds.

[6] Based on the Receiver's ongoing investigation, it appears that even before the October 2005 trading loss, Illarramendi caused the falsification of the books and records of HVP Offshore in connection with certain investments he directed with money from the fund.

[7] Ontime was an entity controlled by Illarramendi's brother-in-law Rufino Gonzalez-Miranda. (*See* Decl. FN1.)

The Fraudulent Scheme also involved a pattern of falsely recording phony investments on the books of the HVP Funds in or with offshore entities that Illarramendi controlled for purposes of executing transactions related to the scheme, such as Naproad Finance, S.A. ("Naproad"), HPA, Inc. ("HPA"), Ontime and Pamac Securities S.A., ("Pamac"). (*See* Decl. ¶¶ 24-25, 41-49.) This enabled Illarramendi to fraudulently conceal the hole and engage in off-the-books transactions using money transferred from the HVP Funds to those entities. Entities such as Naproad, HPA, and Pamac essentially served as smokescreens for the Fraud. Similarly, maintenance of the Fraud depended upon the constant transfer of funds obtained from others to the HVP Funds to make it falsely appear that previously recorded phony investments in entities such as Naproad, HPA and Pamac were being redeemed. These transfers of other people's money, under the false pretenses of redeeming non-existent investments, helped conceal the hole by making it look like significant profits were being earned, when in reality the HVP Funds were concealing staggering losses. For the most part, these transactions expanded the hole as those whose money Illarramendi utilized to conceal the hole demanded rich and, at times, outlandish profits. Thus, the efforts to conceal the hole over time led to its astronomical expansion.

During late 2005 and 2006, Illarramendi added a new wrinkle to his efforts to conceal the hole which would be repeated later in different forms. Rather than merely trying to hide the hole, Illarramendi unsuccessfully attempted to fill it by unauthorized, off-the-books trading, including speculative trades in the securities of Google, Yahoo and other companies. (*See* Decl. ¶ 24.) For the most part, these trades were financially disastrous and caused the hole to grow exponentially larger. (*See id.*) Throughout this and later stages of the Fraud, Illarramendi, using HVP Partners and other entities, continued to execute fraudulent transactions designed to hide the ongoing losses with commingled funds newly obtained from various third parties.

By the first quarter of 2006, Illarramendi, Lopez and Luth changed the form of the Offshore Fund hedge fund to a "master-feeder" structure by incorporating the Master Fund, turning HVP Offshore into an offshore feeder, and creating HVP LP as a domestic feeder. (*See* Decl. ¶ 10.) Lopez and three Ogier employees became directors of the Master Fund.[8] (*See* Decl. ¶ 11.) On April 1, 2006, the Master Fund entered into an investment management agreement with HVP Partners ("Master Fund IMA"), granting HVP Partners the same absolute investment and contracting powers over the Master Fund as the Offshore IMA had granted over HVP Offshore. (*See* Decl. ¶ 11, Ex. E 1-2.) Notably, even the HVP Funds' own legal adviser, Ogier, would address correspondence to the HVP Funds at the Stamford, Connecticut office of HVP Partners, a *de facto* acknowledgement by even the lawyers for the HVP Funds of the lack of respect for what should have been the "separate" and "independent" corporate structures and the formalities of the HVP Funds. (*See* Decl. ¶ 12.)

By as early as the summer of 2006, Illarramendi had explicitly informed Lopez of the existence of the hole. Lopez told Illarramendi that the hole could not be disclosed to investors, but had to be fixed. (*See* Decl. ¶ 11, Ex. A 360-65.) In effect, Lopez and Illarramendi agreed to continue the scheme to conceal the hole. By August 2006, the hole had grown to at least $33 million, comprising more than one-third of the assets of the HVP Funds. (*See* Decl. ¶ 24.) The insolvency of the HVP Funds continued to dramatically deepen.

During 2007 and 2008, in addition to continuing to execute fraudulent transactions to hide the hole, Illarramendi, through HVP Partners, utilized money from the HVP Funds to execute high risk Venezuelan currency arbitrage transactions. (*See* Decl. ¶ 50.) Although these

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[8] At various times, the HVP Funds' directors included Ogier appointees David Sargison, Andrew Eastabrook, Vijaybalan Murugesu, Scott Dakers, Thomas Parsons and Evan Burton.

transactions generated huge profits for Moris Beracha[9] and PDVSA,[10] the HVP Funds did not similarly benefit from the trades. (*See id.*) This stage of the Fraud was characterized by increasingly desperate loans and the diversion and misappropriation of investor funds to and by South and Central American entities and individuals. Some of these diverted funds appear to have been used to bribe at least one PDVSA official. (*See id.*)

Throughout the execution of the Fraud and in contravention of the supposed legal separateness of the HVP Funds and MK Funds, money ostensibly belonging to the HVP Funds or an MK Fund was misappropriated and diverted for the benefit of HVP Partners' principals and employees. For example, in January 2006, significant funds were transferred by HVP Offshore to Naproad to enable, among other things, $55,000 in payments to Illarramendi and his sister Adela Illarramendi, and a $100,000 payment to Luth. (*See* Decl. ¶ 33.) Again, in January 2008, Naproad made transfers of $133,000 to each of Illarramendi, Luth, and an entity controlled by Lopez called Argenta Management Inc. (*See* Decl. ¶ 81.) These transfers were primarily funded with loans that were subsequently repaid using funds derived from Venezuelan currency arbitrage transactions that utilized money from the Master Fund. (*See id.*) HVP Partners' Chief Compliance Officer and CFO, Victor Chong, also received an off-the-books "bonus" payment of $60,000 from Naproad, after it received significant funds from the Master Fund. (*See* Decl. ¶ 80.) In January 2009, the Master Fund transferred funds to Ontime, which then paid $480,000

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[9] Moris Beracha is a Venezuelan national and finance and management executive with over twenty years of experience in finance and various other industries.

[10] "PDVSA" refers to the following funds of the Venezuelan state-owned oil company, Petroleos de Venezuela S.A.: APJ International Limited; Asociacion Civil Administradora de los Fondos de Pensiones de los Jubilados de Petroleos de Venezuela, S.A. y sus Filiales; Fondo Prevision Trabajadores de Petroleos de Venezuela S.A. y sus Filliales; and PDVSA Institucion Fondo de Ahorros.

each to Luth and Illarramendi, $50,000 to Chong, and $400,000 to an entity hired to build Illarramendi's residence in Connecticut. (*See* Decl. ¶ 78.) Again, in February 2009, the Master Fund transferred funds to Ontime, which then paid $75,000 to Luth, $100,000 to Illarramendi and another $400,000 to Illarramendi's residential contractor. (*See* Decl. ¶ 79.)

In an even more outrageous example of looting, this time of the MK Venezuela Fund, money which originated at the MK Venezuela Fund was misappropriated in May 2009 to provide the following significant payments: $500,000 to Illarramendi, $500,000 to an entity owned by MK Group principal and Chief Executive Officer, Odo Habeck ("Habeck"), and another $935,000 to Illarramendi's contractor. (*See* Decl. ¶ 71.) Additional looting of the MK Venezuela Fund in June 2009, resulted in the following significant payments: $1.1 million to Luth, $500,000 to Illarramendi, and $500,000 to an entity owned by Habeck and his wife. (*See* Decl. ¶ 69.) The looting of the MK Venezuela Fund continued in March 2010, when approximately $4 million from the MK Venezuela Fund was transferred to Underhill Investments S.A., a company linked with Lopez's family, only to be later misappropriated as follows: Luth received $1.267 million, Illarramendi received $1.267 million, and an HVP Partners employee received an off-the-books payment of $155,000.[11] (*See* Decl. ¶ 73, Ex. J.) These egregious misappropriations of money from the Funds fly in the face of any argument that the HVP Funds and MK Funds were operated in accordance with their supposed separate corporate legal structures. Clearly, the corporate formalities and structures of these entities were routinely disregarded.

[11] An email between Illarramendi and Lopez suggests that $1.267 million was likewise transferred for the benefit of Lopez. (*See* Ex. J.)

As losses and the costs of concealment at the HVP Funds became more difficult to hide, from at least late 2007, Illarramendi began to expand the Fraudulent Scheme by organizing the MK Entities[12] and MK Funds to raise money that would in large part be fraudulently transferred to, and commingled with the HVP Funds. (*See* Decl. ¶ 65.) During this period, the web of commingled transactions became even more complicated and convoluted, and the taint of commingled funds pervaded the HVP Funds. (*See id*.) Eventually, Illarramendi caused the fraudulent transfer and commingling of more than a quarter of a billion dollars from the MK Funds and certain MK Entities to or for the benefit of the HVP Funds. As a result of the Commission's examination of the HVP Funds, which lead directly to the investigation of the MK Funds, the filing of the enforcement action, and the Court's freeze order, the entire Fraudulent Scheme finally collapsed. Thereafter, Illarramendi estimated before this Court that the amount of losses he had inflicted on the combined enterprise would likely exceed $300 million. (*See* Ex. A 355.)

In sum, although the Hearing Evidence alone sufficiently supports the granting of the Motion, the totality of the Evidence overwhelmingly supports the expansion of the Receivership to include the HVP Funds.

ARGUMENT

I. THIS COURT SHOULD EXERCISE ITS EQUITABLE POWERS AND BROAD DISCRETION TO BRING THE HVP FUNDS INTO THE RECEIVERSHIP

This Court should exercise its broad powers to expand the Receivership to include the HVP Funds. *See generally Rosen v Siegel* 106 F.3d 28, 34 (2d Cir. 1997) (decision to appoint receiver reviewed only for abuse of discretion). The HVP Funds were both integral to the Fraud

[12] MK Consulting LLC was organized in 2006.

and inseparably intertwined with the Receivership Entities. The HVP Funds should finally be recognized for what they are—members of one unified fraudulent enterprise that began at HVP Offshore in 2005, with a multi-million dollar loss concealed on its books, and whose primary purpose was to continue to conceal the hole at the HVP Funds.

As an initial matter, it should be noted that courts routinely bring foreign entities into domestic receiverships. *See Lancer v. CITCO Group Ltd.*, No. 05-60080-CIV, 2011 WL 1233126 (S.D. Fla. Mar. 30, 2011) (domestic receivership of two British Virgin Island hedge funds); *Mut. Benefits Offshore Fund v. Zeltser*, 32 Misc. 3d 1241(A) (Sup. Ct. N.Y. Co. 2011) (domestic receivership of a British Virgin Island hedge fund). This is particularly non-controversial where, as here, the foreign entities are dominated and controlled by domestic principals to further a fraudulent scheme. *See Byers*, 637 F. Supp. 2d at 168 (placing two offshore hedge funds into domestic receivership after being implicated in Ponzi scheme).

When considering expanding a receivership to encompass entities involved in the underlying conduct, a federal court may exercise its equitable powers to disregard corporate separateness and form and instead give effect to the substance of the enterprise. *See Elmas.*, 620 F. Supp. at 233; *see also SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1103 (2d Cir. 1972) (the district court has the "necessary power to fashion an appropriate remedy" where equitable jurisdiction has been invoked by showing of securities law violation); *SEC v. Credit Bancorp, Ltd.*, 124 F. Supp. 2d 824, 827 (S.D.N.Y. 2000) (citing *SEC v. Elliott*, 953 F.2d 1560, 1569 (11th Cir. 1992)); *FDIC v. Bernstein*, 786 F. Supp. 170, 177 (E.D.N.Y. 1992) (the "district court has extremely broad discretion in supervising an equity receivership and in determining the appropriate procedures to be used in its administration.").

Although piercing the corporate veil principles may be considered in determining whether to expand a receivership, "[f]ederal analysis gives less respect to the corporate form than does the strict common-law alter ego doctrine." *Elmas*, 620 F. Supp. at 234. Specifically, in a federal receivership context, a corporate entity may be disregarded "in the interests of public convenience, fairness, and equity," and to do so, "it is sufficient that if [the court] recognized the separate corporate existence, [the court] would bring about an inequitable result." *Id.* at 233-34.

Elmas is particularly instructive concerning the expansion of a receivership. In granting the receiver's motion to bring several entities into a Receivership, the *Elmas* court applied a flexible, yet comprehensive approach, and discussed the following considerations, among others: (1) commingling of funds and other assets; (2) unauthorized diversion of funds or assets to non-corporate purposes; (3) diversion of assets from a corporation by or to a stockholder or other person or entity to the detriment of creditors; (4) treatment by an individual of corporate assets as his own; (5) insolvency of the corporation; (6) failure to maintain arm's length relationships among related entities; (7) failure to observe corporate formalities; (8) concealment and misrepresentation of the ownership of the entities or of personal business activities; (9) common officers and directors, or shared supervision and management; and (10) use of the entity as a subterfuge for illegal transactions. *Id*. at 233-34; *see also Elliott*, 953 F.2d at 1565 n.1 (court may extend equitable receivership over related entities). Significantly, in assessing these factors, the *Elmas* court added entities into the receivership on the basis of fewer factors than those found here. *Elmas*, 620 F. Supp. at 236-38, 239-40 (commingled assets, incorporation by same organization used by defendants to incorporate, and presence of officer who was the daughter of a defendant sufficient to include entity in receivership). The court stressed that the approach was necessarily "flexible" in a Commission enforcement action where the primary objective was to "ensure that all available assets are brought within the receivership and may then be properly distributed to creditors." *Id*. at 234. Like *Elmas*, the present case is a Commission enforcement action initiated to prevent further securities law violations is to ensure that all available assets are brought within the Receivership to be properly distributed to creditors.[13]

In *Byers*, then District Court Judge Chin addressed objections by investors in master-feeder hedge funds to the inclusion of the funds in a receivership. 637 F. Supp. 2d at 180. As here, the case involved a Ponzi scheme that composed numerous entities, including the master-feeder hedge funds, and the court appointed a receiver for them. After the receiver had been appointed, investors in the hedge-funds objected. *Id.* The court ruled that the master-feeder funds were properly included in the receivership primarily because the funds had been used as part of one overarching fraud by a principal of their investment manager and by another individual who exercised significant control over the money held by the funds. *Id.* Notably, the court made this decision after carefully considering the significant level of commingling of funds from the fraud with those of the master-feeder funds. *Id.* at 177-79.[14] The Second Circuit upheld Judge Chin's inclusion of the master-feeder funds in the receivership. *SEC v. Malek*, 397 Fed. Appx. 711, 715-16 (2d Cir. 2010). The Second Circuit expressly rejected the argument that the master-feeder funds should not have been included in the receivership because the investment manager and its principals were not permitted to own any part of the master-feeder

[13] As the Receiver's investigation is ongoing, the precise manner in which the assets will be distributed to valid claimants, as well as which claims are valid, has yet to be determined.

[14] The amount of commingling in the commodity funds in *Byers* pales in comparison to the massive commingling of funds that this Court has already found in this case. *Compare Byers*, 637 F. Supp. 2d at 179 (discussing hundreds of thousands of dollars of commingling) *with* (Rul. on Mot. for Temp. Restraining Order, Doc 276 at 9-10) (finding that HVP Funds received $180 million from MK Entities for which HVP Funds had no legitimate claim as a result of Illarramendi's financial manipulation).

funds, ruling instead that the investment manager and its principals "paid little regard to the letter of those regulations by, for example, regularly commingling the commodity funds assets." *Id.* at 713. The Second Circuit gave short shrift to the argument that a fund could not be brought into a receivership merely as a result of the fraudulent actions of its investment manager.

In assessing whether to include additional corporate entities in a pre-existing receivership, the Court should be guided both by the precedent of other federal courts exercising similar equitable discretion and Connecticut state law. Indeed, the factors under Connecticut state law largely mirror the factors considered in *Elmas*. *See Breen v. Judge*, 124 Conn. App. 147, 153 (2010); *see also Wells Fargo Bank v. Konover*, No. 3:05-cv-1924 (CFD), 2011 WL 1225986, at *10 (D. Conn. Mar. 28, 2011) (finding commingling of funds significant evidence of lack of independent identity); *Bergesen v. Lindholm*, 760 F. Supp. 976, 989 (D. Conn 1991) (piercing corporate veil where funds of two entities were freely and completely commingled). In order to assess whether to pierce the corporate veil and thereby include a corporate entity within a Receivership, a court may consider a combination of the following factors: (1) the absence of corporate formalities; (2) inadequate capitalization; (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes; (4) overlapping ownership, officers, directors, personnel; (5) common office space, address, phones; (6) the amount of business discretion by the allegedly dominated corporation; (7) whether the corporations dealt with each other at arm's length; (8) whether the corporations are treated as independent profit centers; (9) payment or guarantee of debts of the dominated corporation; or (10) whether the corporation in question had property that was used by other of the corporations as if it were its own. *Breen*, 124 Conn. App. at 153. As piercing the corporate veil is equitable in nature, no hard and fast rule governs, and the court is empowered to assign weight to the factors under the particular facts in reaching its decision. *Id.*

II. EQUITY REQUIRES THE EXPANSION OF THE RECEIVERSHIP TO INCLUDE THE HVP FUNDS

The Evidence in the instant matter overwhelmingly establishes that the expansion of the Receivership to include the HVP Funds is proper and required to achieve equity. The HVP Funds' involvement in and significant benefit from the execution of the overarching Fraudulent Scheme, combined with the staggering level of commingling of other people's money in the accounts of the HVP Funds and the domination and control of the HVP funds to execute the fraud, plainly justify expansion of the Receivership to include the HVP Funds. Added to these persuasive facts are the following additional considerations that unequivocally mandate expansion of the Receivership: (1) Illarramendi disregarded, and consistently caused HVP Partners to disregard the corporate formalities and supposed legal separateness of the HVP Funds; (2) Illarramendi used HVP Partners and other entities to loot, divert and misappropriate the assets of the MK Funds and the HVP Funds in the Fraudulent Scheme; (3) at the time of the discovery of the Fraudulent Scheme, commingled proceeds of the Fraud held in the accounts of the HVP Funds were in fact largely, if not completely, derived from the MK Funds; and (4) inclusion of the HVP Funds within the Receivership Estate is the only way to ensure an equitable distribution to all of Illarramendi's victims, investors and creditors alike.

A. <u>Extensive Commingling between the HVP Funds and Certain Receivership Entities Compels Expansion of the Receivership</u>

As detailed above, the execution of the Fraudulent Scheme involved the routine and extensive commingling of other people's money with that of the HVP Funds. In the later stages of the Fraud, this massive commingling included the fraudulent transfer of more than a quarter of a billion dollars just from the MK Funds and MK Entities presently within the Receivership

Estate which occurred. Well before these transfers, tens of millions of dollars of other people's money had been previously commingled with that of the HVP Funds. Indeed, the commingling began at least as early as the moment Ontime transferred $7.4 million to HVP Offshore on or about December 15, 2005, to falsely make it appear that the phony Ontime investment had actually been redeemed. Illarramendi used monies that HVP Partners borrowed from BCT Bank to make that transfer which was falsely recorded on the books and records of HVP Offshore as a redemption of an investment. (*See* Decl. ¶¶ 19-23.) By August 2006, money received from the following entities had been commingled with that of the HVP Funds, and Illarramendi contemporaneously, falsely recorded the received transfers as belonging to the HVP Funds as "redemptions" of prior purported investments: Stewart Title Latin America, Inc., HVP Partners, Global Jack's, S.A., Alimentos Jack's de Centroamerica, S.A., Ponter Investments, S.A., and Taylor & Cruz, S.A. (*See* Decl. ¶ 82.) By the time the Fraud collapsed in early 2011, the HVP Funds contained monies fraudulently diverted from PDVSA, the MK Funds, Fractal and too many other entities and individuals to list here, all commingled with investor monies.

In addition, the HVP Funds' recycling of commingled monies to make other investments tainted those investments and any profits or proceeds they may have generated. In his testimony before the Court, Joseph Floyd[15] in essence described one example of how commingled funds tainted other HVP Fund investments when he testified about a transaction in which $34 million of other people's money was transferred from MKV to the Master Fund, which used it to invest in four securities. (*See* Ex. A 297-304.) The Receiver's investigation has confirmed that the use of commingled money by the HVP Funds to make what otherwise might appear to be a

[15] Mr. Floyd is an accountant who was called as a witness by HVP Partners at the May Hearing.

legitimate investment was not an isolated occurrence. The use of commingled funds to make investments forever tainted them, their profits and proceeds, and any subsequent investments made in part or whole from them.

The HVP Funds were irremediably commingled by the time the Fraud was discovered. That alone is an adequate basis for this Court to bring the HVP Funds into the Receivership. *See Elliott*, 953 F.2d at 1565 n.1 (court properly treated various companies as one entity in receivership because defendant "had commingled funds between the various companies and had failed to maintain a strict separation of the companies"); *see also Byers*, 673 F. Supp. 2d at 177-78 (noting that courts have found any commingling sufficient to satisfy similarly-situated prong of receivership *pro rata* distribution plan) (citations omitted) *aff'd sub nom. Malek*, 397 Fed. Appx. at 715-716 (refusing to disturb lower court holding in light of substantial evidence of extensive commingling).

B. Illarramendi Caused the HVP Funds to Engage in Improper and Unauthorized Diversions and Misappropriations of Investor Monies

During the execution of the Fraudulent Scheme, money from the HVP Funds was routinely diverted and misappropriated, and the HVP Funds also received hundreds of millions of dollars of money misappropriated from other entities such as the MK Funds, to conceal the hole. As demonstrated above, it was commonplace for money to be transferred from the HVP Funds for the purpose of facilitating the fraud with the transfers falsely documented in the books and records of the HVP Funds as purported investments. These transfers caused HVP Funds' money to end up in the hands of numerous entities such as Fractal Fund Management, Ltd., Stewart Title Latin America, Inc., Goldenbird Finance, S.A., Ponter Investments, S.A., Heptagon Asset Management C.V., Web Financial Services, Bradleyville Limited, La Signoria Assets Corp., Rowberrow Trading Corp., Vetra Energy Group, LLC, and others. (*See* Decl. ¶ 83.) In effect, money from the HVP Funds was misappropriated for unauthorized purposes in contravention of the HVP Funds' organizational, investment management and other legal documentation.

In fact, more than a quarter of a billion dollars misappropriated from the MK Funds and MK Entities was diverted to or for the benefit of the HVP Funds. (*See* Decl ¶ 65.) The rampant and indiscriminate diversion, misappropriation and commingling of assets of the MK Funds and the HVP Funds strongly support piercing the corporate veil of the HVP Funds and including them in the Receivership. *See Bergesen*, 760 F. Supp. at 989 (piercing corporate veil where funds of two entities were freely and completely commingled); *see also Tucker v. American Intern. Group, Inc.*, 745 F. Supp. 2d 53, 70 (D. Conn. 2010) (adherence to fiction of separate identity would defeat justice and equity by permitting entity to escape liability from operation conducted by one corporation for benefit of whole enterprise).

C. <u>Illarramendi Caused the HVP Funds to Fraudulently Divert Assets for the Personal Benefit of its Principals</u>

A classic reason for piercing the corporate veil is the use of funds "put in and taken out of the corporation for personal, rather than corporate purposes." *Breen*, 124 Conn. App. at 153. Throughout the Fraud, assets were, at times, freely diverted for the personal use of Illarramendi, Luth, Lopez, and in some instances HVP Partners' employees. In fact, no less than \$2.2 million was fraudulently transferred from the Master Fund via an offshore entity to or for the benefit of Illarramendi, his family members and business associates, including Luth and Lopez, for their unrestricted personal use. (*See* Decl. ¶¶ 33, 78-80.) In addition to that, no less than \$6.7 million was transferred from MK Venezuela Fund to or for the benefit of Illarramendi, HVP Partners' principals and employees, and the CEO of MK Group, Odo Habeck, for their unfettered personal use. (*See* Decl. ¶¶ 69-71, 73.) Fraudulently commingled monies in the Master Fund were also used to pay HVP Partners' employees off-the-books bonuses, further exposing the unity among the HVP Funds, HVP Partners and MK Entities, and demonstrating the need for expansion of the Receivership. *See Elliott*, 953 F.2d at 1565 n.1 (consolidating different entities for receivership purposes because of commingling of funds); *see also Davenport v. Quinn*, 730 A.2d 1184, 1197 (Conn. App. Ct. 1999) (piercing corporate veil where owner commingled funds and removed assets from one entity to pay another entity's expenses). Finally, money appears to have been improperly—and illegally—used to pay kickbacks to at least one PDVSA pension funds official. These instances of looting the HVP Funds provide ample basis for the expansion of the Receivership.

D. <u>The HVP Funds Have Been Insolvent Since the Inception of the Fraud</u>

Courts frequently consider inadequate capitalization as a basis to pierce the corporate veil and bring an entity into a Receivership. At the very beginning of the Fraud, Illarramendi concealed a $5.2 million hole on HVP Offshore's books by falsely reporting a non-existent asset on its balance sheet. At that point, there was a difference between reported assets and actual assets available to satisfy the HVP Offshore Fund's liabilities. This hole grew exponentially during the course of the Fraud, while redemptions based upon falsely calculated net asset values occurred. Thus, since the beginning of the Fraud in 2005, the HVP Funds sustained a substantial and ever growing shortfall between their reported assets and actual assets, and also between their reported liabilities and actual assets. In other words, from the start of the Fraudulent Scheme, the HVP Funds were insolvent. *See* Connecticut Uniform Fraudulent Transfer Act (CUFTA), Conn. Gen. Stat. § 52-552c(a) (providing that "a debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation"). As the hole only expanded over time, the HVP Funds remain insolvent today.

E. <u>HVP Partners and Illarramendi Failed to Maintain Arm's Length Relationships with the HVP Funds</u>

Yet another basis for expanding the Receivership is that HVP Partners and Illarramendi failed to maintain arm's length relationships with the HVP Funds. The constant commingling of other peoples' money in the HVP Funds' account to keep the Ponzi scheme afloat highlights the lack of arms-length relationships among the entities Illarramendi and his confederates dominated and controlled. For example, on numerous occasions Illarramendi caused HVP Partners to borrow money from BCT Bank and transferred it to one of the HVP Funds via another entity in order to make it appear that a falsely recorded phony investment had been redeemed. (*See* Decl. ¶¶ 14, 22, 51.) Similarly, Illarramendi used HVP Partners to divert and misappropriate monies from the HVP Funds every time he caused management fees to be paid based on false net asset values reported by HVP Partners. There is no better example of the lack of an arm's length relationship with the HVP Funds than the constant transfers of money out of the HVP Funds to pay back others who had transferred funds to the HVP Funds in order to keep Illarramendi's Ponzi scheme alive and concealed.

The fraudulent diversion of millions of dollars from the MK Funds similarly highlights the failure to maintain arms-length relationships between the HVP Funds and the MK Funds. Needless to say, there was nothing "arm's length" about the illegal transfers of funds from the Receivership Entities to the HVP Funds. These are just a few of the many examples of Illarramendi and the HVP Partners' complete failure to maintain any sort of arms-length relationship with the HVP Funds and other entities, which further underscore that the HVP Funds served as little more than mere instrumentalities of the Fraudulent Scheme. *See Wells Fargo Bank*, 2011 WL 1225986, at *6 (absence of arm's length dealing is factor in determining whether entity is mere instrumentality of another); *see also Breen*, 124 Conn. App. at 153.

F. Corporate Formalities Were Consistently Ignored

As the preceding factors demonstrate, Illarramendi and HVP Partners routinely disregarded the corporate formalities and legal separateness that were supposed to govern and protect the HVP Funds and HVP Partners. Their disregard of corporate formalities and structure is also highlighted by the regular and extensive falsification of the books and records of the HVP Funds to reflect the creation and redemption of phony investments. The disrespect of corporate structure is further established by the payment of off-the books transfers to HVP Partners' principals and bonuses to HVP Partners' employees using money that was diverted from the HVP Funds in violation of the relevant Investment Management Agreement. An apparent off-the-books early redemption of Hotelera Playas Minas' ("Hotelera") investment in the HVP Funds in contravention of the HVP Funds' policies provides yet another example of disregard for corporate formalities and structure. (*See* Decl. ¶¶ 58-64.) Throughout the relevant period, the corporate formalities and legal structure of the HVP Funds, the MK Funds, and other entities were regularly ignored as the entities were used as mere pawns and instrumentalities to execute the Fraudulent Scheme.

The dominant director of the HVP Funds, Lopez, knew that the corporate separateness and formalities of the HVP Funds were being violated. Indeed, Lopez specifically directed that the hole be concealed and participated in Hotelera's apparent off-the-books redemption. (*See* Decl. ¶¶ 37, 60, Ex. A 360-65.) The other directors were nowhere to be found when this total abrogation of the corporate structure of the HVP Funds occurred right under their noses.

G. The Principals of HVP Partners Dominated and Controlled the HVP Funds

It cannot seriously be disputed that Illarramendi and HVP Partners completely dominated and controlled the HVP Funds in committing the Fraud. Abundant examples as set forth above, in Illarramendi's testimony and in the Declaration, conclusively demonstrate Illarramendi's extensive domination and control of the HVP Funds, the disregard of the corporate structure and formalities of the HVP Funds, and the abuse of their corporate form to commit fraud and other wrongdoing. These examples include: (1) flagrant falsification of the HVP Funds' books and records, (2) massive commingling of other people's money with that of HVP Funds; (3) maintenance of an off-the-books bank account at the BCT Bank for HVP Offshore; (4) apparent off-the-books redemption of Hotelera's investment in violation of the HVP Funds' legal documentation; (5) the fact that even Ogier, the HVP Funds' counsel, directed correspondence to the HVP Funds and HVP Partners at an address in Connecticut; and (6) receipt by HVP Partners' principals of side payments that originated with money diverted from the HVP Funds in violation of the relevant Investment Management Agreements.

Notwithstanding their organization on paper, the HVP Funds were always the captive creation of the principals of HVP Partners, Illarramendi, Lopez and Luth, who created and utilized the HVP Funds merely to serve as a vehicle for them to raise and manage funds. The HVP Funds were never truly independent, separately existing and managed entities. Until the discovery of the Fraud, the decisions relating to the operations of the HVP Funds were effectively made by HVP Partners and Illarramendi, who dominated and controlled the funds to execute the Fraudulent Scheme. All investment, banking, marketing, research, and administrative decisions were made by Luth, Lopez and Illarramendi, and rubber-stamped by the HVP Funds' directors, only if and when absolutely necessary, and often not at all.

The HVP Funds can find no solace in their claim that they were overseen by "independent" directors. Lopez was the dominant director and in essence controlled the HVP Funds during the relevant time period. Lopez knew of, and directed the concealment of the "hole" for at least some period time, and also knew or should have known of the falsification of records at the HVP Funds, and the disregard of the structure and corporate formalities of the HVP Funds. The HVP Funds cannot escape this knowledge and participation in the fraudulent conduct by the dominant director of the funds.[16]

When noticed for testimony by the Receiver, two of the HVP Partners' Principals and its CFO—Lopez, Luth and Chong respectively—refused to answer any substantive questions, invoking their Fifth Amendment rights. (Decl. ¶ 84.) This failure to provide an alternate narrative further compels this Court to conclude what is obvious anyway, namely, that these executives dominated and controlled the HVP Funds. *See Elmas*, 620 F. Supp. at 235 (refusal to testify at receiver's notice is "pivotal issue" in determining entities' status in receivership).

H. <u>The HVP Funds Were Used as the Instrumentality for Criminal Conduct and Illegal Activity</u>

Finally, as demonstrated by the preceding discussion, since October 2005 the HVP Funds have served as instrumentalities to commit fraud and other illegal activity. Illarramendi utilized the HVP Funds to conduct the Ponzi scheme that is the subject of these proceedings. In addition, as detailed above, the HVP Funds also appear to have been used in a scheme to pay kickbacks to at least one PDVSA pension fund official. Such a scheme would appear to violate The Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-1. In this regard, it is beyond dispute that the HVP Funds were clearly used as a subterfuge for illegal transactions intended to benefit Illarramendi, the principals of HVP Partners and the HVP Funds. The inequity of now using the corporate form to shield the HVP Funds from answering for their wrongful acts would be

[16] This is particularly true given that none of the facts presented herein have been disputed by the principals of HVP Partners. In connection with the Receiver's investigation into the Fraud, his counsel noticed the testimony of Lopez, Luth and Chong. Each chose to invoke his Fifth Amendment right to refuse to incriminate himself by testifying. During the three depositions, none of the witnesses answered a single substantive question posed to them.

astounding—particularly because the conduct of their agent, Illarramendi, is imputed to the HVP Funds. *See Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111, 195 (2d Cir 2010) (alter ego liability appropriate when a parent or owner uses corporate form "to achieve fraud"), *cert. granted*, 132 S.Ct. 472 (2011); *see also Tucker*, 745 F. Supp.2d at 70 (D. Conn. 2010).

In sum, the considerations set forth above clearly require that the HVP Funds be brought into the Receivership. Any other result would be contrary to settled precedent and contrary to sound principles of equity.

III. ONLY CONSOLIDATING THE HVP FUNDS INTO THE RECEIVERSHIP WILL RESULT IN AN EQUITABLE RESULT

The Court has the equitable power to bring the HVP Funds within the Receivership, and equity requires this result. It defies logic that the HVP Funds, which Illarramendi used to launch his Fraud, remain outside of the Receiver's authority while other instrumentalities of the Fraud are within the Receivership. Unless the HVP Funds are brought within the Receivership—where the Receiver and the Court can fashion an appropriate remedy to address the harm caused by the Fraudulent Scheme in a fair and equitable manner—the Receiver will be forced to commence and litigate fraudulent transfer and other claims which the MK Entities have against the HVP Funds. Given the Evidence, there cannot be any serious doubt of the merits of such litigation. Forcing the Receiver to litigate such actions would add insult to injury to aggrieved investors and creditors, as the monies otherwise available to compensate them for the Fraud would instead be dissipated in both pursuing and defending wasteful litigation. Such an absurd result would be contrary to principles of equity.

Contrasted with the prejudice the Receivership Entities will suffer if the HVP Funds are not brought into the Receivership, there is no countervailing harm to the HVP Funds. The HVP Funds are no longer operating and all securities have been liquidated into a bank account. If the

HVP Funds ever served a purpose other than to perpetuate the Fraud, they serve no purpose now, and have no real interests to protect. They are merely a dormant shell between the victims and the proceeds of the Fraud. They should be consolidated within the Receivership as quickly as possible to permit the Receiver to formulate an equitable distribution plan. Assuming *arguendo*, that some legitimate claims by creditors of the HVP Funds are interposed, the distribution plan would likely include distributions to such creditors if the HVP Funds are brought into the Receivership.

Because the HVP Funds do not have any active operations and the money that this Court ordered repatriated does not belong to them, that money must be distributed to victims of the Fraudulent Scheme. If the HVP Funds are not rolled into this Receivership, there is a risk that some other authority, such as a Cayman Island liquidator, will seek to obtain and distribute the money in a separate proceeding. The introduction of another distribution authority into this process would be at best inefficient, and at worst disastrous. A new liquidator would need to be educated on the extremely complex Fraud that this Court and the Receiver already understand, at the expense of great time and cost. Moreover, given the intertwined nature of the Fraud, most, if not all, of the same parties that are involved in the Receivership before this Court would also have to appear in the Cayman Islands, adding further unnecessary inconvenience, delay and cost. Likewise, because the Receiver would have claims against another estate for monies fraudulently transferred from the MK Entities and HVP Partners, that same money would be needlessly subject to dueling distributors under dueling legal regimes. This result would be particularly unconscionable given that claims by the Receiver exceed the balance of money remaining in the HVP Funds. Furthermore, the money that would be the subject of such a dispute is located not in the Cayman Islands, but rather here in the United States under this Court's control. Permitting the HVP Funds to remain outside the Receivership will create inefficiency and waste. Such a result would be inequitable, and this Court should avoid it by consolidating the HVP Funds into the existing Receivership.

IV. ARGUMENTS PREVIOUSLY ADVANCED BY THE HVP FUNDS IN OPPOSITION TO THE COMMISSION'S PRIOR MOTION TO EXPAND THE RECEIVERSHIP TO THE HVP FUNDS ARE UNAVAILING

Given the extensive proceedings on the Commission's prior motion to bring the HVP Funds into the Receivership, this Court has already heard the arguments the HVP Funds will likely recycle in opposition to the Receiver's motion. Just as they did in May 2011, those arguments will again fall far short of the mark. This Court already carefully considered and properly rejected the HVP Funds' *Morrison* arguments. Other arguments raised by the HVP Funds are equally irrelevant or meritless. For example, the HVP Funds' oft-repeated refrain that relief should not be granted because the HVP Funds purportedly did nothing wrong conveniently ignores long-established law holding the principal and corporation liable for the knowledge, intent and actions of its appointed agent and managers; contravenes the facts; and conflates the purported "good faith" arguments of the HVP Funds investors with the HVP Funds. *See, e.g., N.Y. Cent. & Hudson Riv. R.R. Co. v. U.S.*, 212 U.S. 481, 494 (1909) (knowledge of both agents and representatives attributed to company). It is an inescapable fact that Illarramendi utilized the HVP Funds and their bank accounts to execute a massive fraud that victimized numerous investors and resulted in hundreds of millions of dollars of commingled proceeds of other people's money tainting the accounts of the HVP Funds. The HVP Funds are charged and imputed with the culpable intent, knowledge and actions of their agents, including Illarramendi.

The HVP Funds' prior attempts to distance themselves from the conduct of their agents and investment manager by arguing that they are separate and distinct Cayman entities, whose separate corporate status should be respected, flies in the face of numerous inconvenient truths the HVP Funds apparently do not wish to acknowledge. As is set forth above, the Receiver has discovered overwhelming evidence relating to the domination and control of the HVP Funds by Illarramendi using HVP Partners in executing the Fraudulent Scheme.

Finally, the HVP Funds' prior argument that they have an incontestable, exclusive and legitimate interest in the pervasively commingled monies that happened to remain in the HVP Funds' accounts at the conclusion of the Fraud ignores the incontrovertible facts and established Second Circuit law concerning the legal consequences of the substantial commingling of funds. These facts are established by Illarramendi's admissions during the process of pleading guilty and in his testimony before this Court, as well as the Evidence, some of which is further detailed in the Declaration.

The reality is that remaining investors in the HVP Funds at one time may have contributed net amounts which, at most, totaled approximately $164 million. (*See* Decl. ¶ 65.) Illarramendi's fraudulent management of those funds and other funds resulted in staggering losses being sustained by the HVP Funds and others, which were concealed by his Fraudulent Scheme. Illarramendi estimated in testimony before this Court that the hole from his Fraudulent Scheme probably exceeded $300 million, which far outstripped any contribution of principal by the investors in the HVP Funds. (*See* Ex. A 355.) Moreover, Illarramendi's Fraudulent Scheme resulted in the massive commingling of other people's money with that contained in the accounts of the HVP Funds. This Court has already found that the Commission proved in the May Hearing that, in 2009 and 2010 alone, the HVP Funds likely received more than $180 million of money belonging to the MK Funds in which the HVP Funds had no legitimate ownership interest. Additional evidence developed during the Receiver's investigation places that figure at more than a quarter of a billion dollars, well beyond the approximately $228 million that was repatriated to the United States in accordance with the Court's order. (*See* Decl ¶ 65.)

Under these facts, and against the backdrop of well settled law that the Commission (and, hence, a Receiver) is entitled in cases involving the substantial commingling of funds to seek disgorgement of the entire balance of a commingled account, the HVP Funds' arguments relating to a so-called legitimate interest in all of the repatriated funds is a red herring that cannot carry the day. *See SEC v. Aragon Capital Mgmt., LLC*, 672 F. Supp. 2d 421, 443 (S.D.N.Y. 2009) ("[w]here tainted funds have been commingled with potentially legitimate funds, the SEC is entitled to obtain disgorgement from the entire pool of funds); *SEC v. Better Life Club of Am., Inc.*, 995 F. Supp. 167, 181 (D.D.C. 1998) ("[w]hen legitimate assets are commingled with illegitimate ones such that the assets cannot be separated out, a constructive trust may extend over the entire asset pool"). *See also United States v. Ward*, 197 F.3d 1076, 1083 (11th Cir. 1999) (when money is commingled, illicitly-acquired funds and legitimately-acquired funds cannot be distinguished from each other); *United States v. Garcia,* 37 F.3d 1359, 1365-66 (9th Cir. 1994) (under money laundering statute, presence of some tainted funds in commingled account sufficient to taint legitimately-acquired funds in same account); *Byers*, 637 F. Supp. 2d at 177 (noting courts have concluded that, due to the fungibility of money, any commingling warrants treating all funds as tainted); *SEC v. Lauer*, No. 03 Civ. 80612 (KAM), 2009 WL 812719, at *5 (S.D. Fla. Mar. 25, 2009) (declining to attempt to segregate tainted funds in commingled account because presence of some tainted funds sufficient to taint all).

CONCLUSION

Based on the foregoing, the Receiver respectfully requests that the Court grant the Receiver's Motion to include the HVP Funds in the Receivership.

NOTICE

Notice of this Motion has been given to all parties by electronic filing of this motion. The Commission has no objection to the relief requested.

In light of the nature of the relief requested, the Receiver submits that such notice is good and sufficient, and no other or further notice is necessary or required.

WHEREFORE, the Receiver respectfully requests that the Court enter an order substantially in the form of Exhibit A hereto: (a) granting this Motion; (b) approving the expansion of the Receivership to include the Master Fund, HVP Offshore, HVP L.P.; and (c) granting the Receiver such other and further relief as is just and proper.

Respectfully submitted this 2nd day of February, 2012.

/s/
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