UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
FORT MYERS DIVISION

CASE NO.: 2:09-CV-229-FTM-29SPC

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

FOUNDING PARTNERS CAPITAL MANAGEMENT COMPANY, and WILLIAM L. GUNLICKS,

Defendants,

FOUNDING PARTNERS STABLE-VALUE FUND, LP, FOUNDING PARTNERS STABLE-VALUE FUND II, LP, FOUNDING PARTNERS GLOBAL FUND, LTD., and FOUNDING PARTNERS HYBRID-VALUE FUND, LP,

Relief Defendants.

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RECEIVER'S PRE-HEARING SUBMISSION

The Receiver Daniel S. Newman, not individually, but solely in his capacity as the Court-appointed receiver ("Receiver") for Founding Partners Capital Management Company ("FPCMC"); Founding Partners Stable-Value Fund, L.P. ("Stable Value"); Founding Partners Stable-Value Fund II, L.P. ("Stable Value II"); Founding Partners Global Fund, Ltd. ("Global Ltd.") and Founding Partners Hybrid-Value Fund, L.P. ("Hybrid Value") (Stable-Value, Stable Value II, Global Ltd., and Hybrid Value are collectively called the "Receivership Funds") (collectively, the Receivership Funds and FPCMC are called the "Receivership Entities"), respectfully submits this Pre-Hearing Submission.

INTRODUCTION

First, this submission sets forth the Receiver's position regarding his request for an order under Section 3(a)(10) of the Securities Act of 1933, in advance of the hearing scheduled for June 10, 2014.

Second, this submission also sets forth the Receiver's request concerning the form of order, should the Court approve the distribution of membership interests upon the June 10, 2014 hearing.

I. The Receiver's Position Regarding Section 3(A)(10) of the Securities Act of 1933

The Receiver respectfully submits that the basis for the exemption to the obligation to file a registration statement for the issuance of interests in FP Designee, pursuant to Section 3(a)(10), was established based on the totality of the *Sun Litigation* (as defined in previous filings), and the briefing, objections, and final order approving the Settlement Agreement, as demonstrated below.

A. GENERAL PRINCIPLES

Section 3(a)(10) provides an exemption to the obligation to file a registration statement for:

> Any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval.

15 U.S.C. s 77c(a)(10).

The leading case on the use of Section 3(A)(10) in the context of the settlement of an SEC litigation is *SEC v. Blinder, Robinson & Co. Inc.*, 511 F. Supp. 799 (D. Colo. 1982).

Although there are some differences between *Blinder* and this case,[1] there are some very strong similarities.

After observing that "there is no statutory definition of 'fairness' as used in Section 3(a)(10) and there is no general guidance suggesting the criteria for the court to consider in determining the question of approval,"[2] the *Blinder* Court explained its limited role:

> In summary, the approach to the determination of "fairness" and approval of this settlement agreement, invoking the exemption from registration provided by Section 3(a)(10), is consistent with recognition of the purpose of the Securities Act of 1933 to protect investors by promoting full disclosure of the information believed to be necessary to the making of informed investment decisions. *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119 at 124, 73 S. Ct. 981 at 984, 97 L. Ed. 1494 (1952). The fairness hearing here has been the functional equivalent of the full disclosure which would be provided in an appropriate prospectus and registration statement. Those receiving the offer under the terms of the settlement agreement have had a full and fair opportunity to learn everything required to make their decision. *Accordingly, it must be concluded that they will act in awareness of the risks involved in acceptance and the alternatives attendant upon a decision to decline the offer. Nothing more could be accomplished by registration and nothing more is required in the determination that this settlement should be approved.*

Blinder, 511 F. Supp. at 802 (emphasis added).

The operative question here, then, is – *have the investors been given sufficient disclosures and warnings roughly equivalent to that of a typical registration statement about the risks of obtaining an ownership interest in FP Designee, such that the exemption to the filing of a registration statement can be justified?*

Thus, the *Blinder Court* further noted that it was <u>not</u> obligated to assess the adequacy of

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[1] *Blinder* involved a civil enforcement proceeding brought by the United States Securities and Exchange Commission (the "SEC") for injunctive and ancillary equitable relief upon claims of violations of the substantive provisions of the federal securities laws. Some of the *Blinder* defendants entered into a settlement agreement involving the offer of common stock and promissory notes to investors in the subject entities in exchange for a release of claims by those who accepted the offer. Before distributing the shares, the plaintiff and settling defendants sought court approval to distribute the shares based on the 3(a)(10) registration exemption.

[2] *Blinder*, 511 F. Supp. at 801.

the settlement terms -- a process that this Court has already undertaken in approving the Settlement Agreement.

> The SEC is not here as the representative of a class of investors claiming relief. Accordingly, this court is not confronted with measuring the adequacy of the relief obtained by comparing the value of the securities to be issued with the claims of loss, as would be true in the settlement of a class action or a derivative action by shareholders under Rules 23(e) and 23.1 of the Federal Rules of Civil Procedure.
>
> Indeed, the settlement specifically provides that those persons who do not wish to accept the offer from the settling defendants are not foreclosed from pursuing private claims for relief. Accordingly, each of the offerees will have an opportunity to evaluate the proposal on an individual basis.

Blinder, 511 F. Supp. at 801.

With its limited role in mind, the *Blinder* Court set forth its views on proper analysis for determining whether this exemption to registration applies to a proposed litigation settlement:

> The factors which are to be considered include: (1) the recommendations of counsel; (2) the scope of the discovery record as an indicator of the adequacy of the investigation into the facts; (3) the apparent alternatives to the settlement; (4) the nature and volume of responses from those receiving notice of the hearing; and (5) the opportunity for direct participation in the process of obtaining full disclosure.

Id.

B. THE COURT SHOULD APPROVE THE EXEMPTION TO REGISRATION

Preliminarily, there is substantial overlap between the five *Blinder* factors applicable to the registration exemption and the six factors [*Sun Litigation*, D.E. 308 at 23][3] that, the Court found, showed the Settlement Agreement term*s* were "fair, reasonable and adequate" [SL, D.E. 308 at 40]. The difference between the Court's previous inquiry and the present inquiry is that previously the moving parties had the burden to show that the Settlement Agreement *terms* were

[3] Docket entries in the *Sun Litigation* will be cited as [SL, D.E. _____].

adequate and sufficient, under the circumstances, whereas here, there is no such requirement to qualify for the exemption from registration, *see supra* at p. 4. Moreover, the key dispute at the hearing on the Joint Motion to Approve the Settlement Agreement[4] was the sufficiency of the *terms* and the claimed need for updated audited financial statements to verify that the terms were (or could, with improvement, be made) acceptable, as argued by Boies Schiller. Neither of those concerns suggest that the investors were not given information and warnings sufficient to put them on notice of the risks inherent in owning these businesses, which is the issue here.

Indeed, the Receiver warned the Court and the investors of the perilous condition of the operating entities and the need for outside funding. [SL, D.E. 300 at 76-80]. In the litigation, the Receiver also raised concerns of alleged wrongdoing. [SL, D.E. 125 at 18-30]. In fact, one of the reasons for the Settlement Agreement was to attempt to begin the turnaround of the entities with new funding, since the imminent demise of the operating entities remained a real possibility, especially if there was no end to the hostilities. These same concerns caused Boies Schiller's clients to be concerned about the proposed Settlement Agreement, and to seek better terms and updated audited financials. At the fairness hearing on March 30, 2012, Mr. Singer, of Boies Schiller, even discussed his clients' views that the entities would likely have to file for bankruptcy. [SL, D.E. 300 at 45-46]. Notably, every one of the Boies Schiller objectors "opted in" to the Settlement Agreement by submitting Investor Releases.

In addition to these warnings, there was a significant volume of due diligence provided or made available to investors (which included, *inter alia*, audited financial statements, a due diligence consultant's report, and an investment banker's valuation). There is no question that the

[4] The Joint Motion to Approve the Settlement Agreement, as used herein, refers to the Joint Motion for Expedited Approval of Proposed Procedure to Obtain Court Approval of the Proposed Settlement Transaction [SL, D.E. 248].

disclosures and warnings provided to investors in connection with the Settlement Transaction, in some ways, equaled or exceeded the type of disclosures typically contained in registration statements.

Given the foregoing, the five *Blinder* factors point to the same conclusion:

1. The recommendations of counsel

The discussion by the *Blinder* Court on this factor is apt:

> Counsel for the parties to this settlement, as officers of the court, have summarized the negotiating history in their statements at the hearing. Additionally, judicial notice was taken of earlier adversary proceedings in this case. There is nothing to suggest any collusion in the preparation and submission of the agreement. To the contrary, it is apparent that these attorneys have represented the interests of their clients aggressively throughout this case; that the settlement is the product of arms-length bargaining; and that their recommendation that this court accept this agreed resolution of the disputed issues results from their exercise of professional judgment as to what is in the best interests of those for whom they appeared.

Blinder, 511 F. Supp. at 801.

The same is true here. Indeed, the Court knows just how hotly contested the Sun Litigation was between the parties. As in *Blinder*, counsel for the settling parties "represented the interests of their clients aggressively throughout the case," "the settlement [was] the product of arms-length bargaining," and counsel's recommendation "result[ed] from their exercise of professional judgment. *Id.*

As the Court observed about the *Sun Litigation* in its Order approving the Settlement Agreement, "[i]ssues seem to abound, and no issue seems too small to demand close attention." [SL, D.E. 308 at 26]. The parties could not agree even on who should participate in the settlement negotiations, and the Defendants initially sought to have the Court approve an earlier version of the Settlement Agreement, to which the Receiver had not agreed. [SL, D.E. 244].

Moreover, the Settlement Agreement was supported by the SEC and by counsel for the Investor Group (as that term was defined in previous filings), which played a key role in the settlement process and negotiations.

2. The scope of the discovery record as an indicator of the adequacy of the investigation into the facts

In *Blinder*, "[t]here ha[d] been time for a complete investigation into the facts in this case and it is apparent that counsel have made full use of discovery procedures."[5] The same is true here, as evident from the court docket in the *Sun Litigation*.

In fact, the investors received substantial disclosure beyond litigation discovery. The Receiver and the Sun Entities provided the investors with due diligence financial and business information about the entities, including the following:

- Consolidating balance sheets and profit and loss statements for Promise for the years ended December 31, 2008, 2009, 2010 and 2011 (profit and loss only for 2011), as well as interim year to date financial consolidating balance sheets and profit and loss statements through March 2010, April 2010 (profit and loss only), May 2010, June, 2010, July 2010, August 2010, September 2010, November 2010, February 2011, March 2011, April 2011, May 2011 (profit and loss only), June 2011, August 2011;

- Consolidating balance sheets and profit and loss statements for Success for the years ended December 31, 2009, 2010 and 2011 as well as interim year to date financial consolidating balance sheets and profit and loss statements through March 2010, May 2010, June 2010, September 2010, February 2011, March 2011, April 2011, May 2011 (profit and loss only), July 2011 and August 2011;

- Promise budgets for 2008, 2009, 2010 and 2011;

- Promise cash flow budgets for 2011;

- Monthly Operating Statistics and Census Trends for the Promise Hospitals;

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5 However, the *Blinder* stated that it was unwilling to examine the discovery record, and noted that it did not ask counsel for its views on the merits of the case. 511 F. Supp. at 801-802. Here, by contrast, those issues were explored in connection with the approval of the Settlement Agreement.

- Monthly Operating Statistics and Admission Trends for the Success Hospitals;
- Accounts Receivable Statistics; and
- Certificates of Need in Florida and related studies.

In addition, the Joint Motion for Approval of the Settlement Agreement provided additional information, including information about the terms of the Settlement Agreement, operating entities at issue, the negotiation process, and nature of the due diligence performed. [SL, D.E. 248]. The Joint Motion for Approval of the Settlement Agreement attached a copy of the proposed Settlement Agreement, an estimated calculation of value by the Receiver's accounting firm, Berkowitz Pollack & Brant, and other materials. [SL, D.E. 248-4, 289].

Further, investors were given the opportunity to obtain, by providing executed confidentiality provisions, additional information, including:

- The disclosure statement exhibit to the Settlement Agreement (redacted only to block out the names of the payees);
- Consolidated cash flow statements and financial statements for the health care facilities;
- A post-closing organizational chart;
- Mr. Baronoff's employment agreement;
- The due diligence report by Focus Management Group;
- Audited Financial Statements for Promise; and
- The report of the investment banker, MTS Health.

Viewing all of this information in its totality, the Court observed:

> It is a fact of litigation life that no one wants to make a settlement decision until the last tidbit of information has been obtained. It is also a fact of litigation life, however, that by the time all information sought is obtained, the benefits of settlement have long since evaporated. It is clear to the Court that a tremendous amount of information has been obtained and shared, although clearly not as exhaustive as it will be if the case is not settled. Further, even if the settlement is rejected and litigation proceeds, not all of the sought by the objectors will

> necessarily be available. The Court finds that the information obtained and shared by the Receiver, as summarized at Doc. #229.pp. 16-22, is sufficient to allow the investors to make intelligent decisions as to the Settlement Agreement.

[SL, D.E. 308 at 28].

3. The apparent alternatives to the settlement

Notwithstanding the different factual background of the *Blinder* litigation, the discussion of this factor in *Blinder* is noteworthy, in that the *Blinder* court was also concerned about the risks of not settling:

> The alternative to this settlement suggested by those who have made objections is a full refund of the public investment. That would require the liquidation of the business entity involved and the result would be only a partial recovery. There is not enough cash for complete restitution. Additionally, there would be no future business activity in developing the hotel-casino and the value of the expenditures made in obtaining regulatory approval and other such capital asset values would be lost. The litigation costs involved in resisting such relief would also be a substantial strain on the resources of the settling defendants, thereby further reducing the value of a recovery if the plaintiff ultimately prevailed.

511 F. Supp. at 802.

Here, the Court provided its view on the need for settlement in its Order on the Defendants' motion for stay, when it stated: "This particular case is not typical and literally cries out for a good faith effort at resolution before the only people left standing are the lawyers and other litigation professionals." [SL, D.E. 202 at 1-1]. Moreover, after full briefing and a hearing, the Court approved the Settlement Agreement – which was premised on the distribution of membership interests in FP Designee through a Rule 3(a)(10) exemption [*see* SL, D.E. 248 at 3, 19] – as "fair, reasonable, and adequate." [SL, D.E. 308 at 40].

4. The nature and volume of responses from those receiving notice of the hearing

The Settlement Agreement was supported by a majority of the investor base. [SL, D.E. 279 at 37-38]. The principal investor objection to the Settlement Agreement was filed by Boies Schiller on behalf of a group of investors representing approximately 1/3 of the investor base measured by estimated net invested capital. Boies Schiller's clients had objected because they wanted, principally: (i) better settlement terms than what was the proposed and the Sun Entities were willing to provide, and (ii) updated audited financial statements that did not exist. *See* [SL, D.E. 260 at 5, 6 n. 6, 13-15]. Neither concern suggests that the investors were not on notice of the risks inherent in ownership of membership interests in FP Designee or that a formal registration is needed. To the contrary, it is precisely because of the objecting investors' concerns about the risks inherent in obtaining equity in the entities that they sought better terms and an update to the audit (which was not realistic or warranted as the Court found, *see* [SL, D.E. 308 at 27-28]). As noted, the objecting investors expected the entities to file for bankruptcy if the *Sun Litigation* was not settled. [SL, D.E. 300 at 45-46]. Clearly, these investors and all others were on notice of the risk of equity ownership.

Finally, all investors were given the chance to "opt out" of the settlement, and preserve their claims, as in *Blinder*. 511 F. Supp. At 801. Notwithstanding their objection, all of Boies Schiller's clients "opted in" to obtain equity interests by submitting investor releases and in order to seek equity interests through Section 3(a)(10).[6] Indeed, over ninety-nine percent of all

[6] In addition, certain investors in Hybrid Value filed an objection to the settlement agreement [SL, D.E. 264], which was not actually an objection but a premature argument about how the Receiver should treat their claim in the Receiver's eventual Claims Submission. Those investors also "opted in" by submitting investor releases. Those investors did not file an objection to the Receiver's Claims Submission.

Finally, an objection to the settlement agreement was filed by the Archdiocese based on concerns about restrictions on cooperating with law enforcement and based on the First Amendment [SL, D.E. 259]; that objection

investors opted to submit releases to participate in the Settlement Transaction and receive equity interests in the FP Designee.

5. The opportunity for direct participation in the process of obtaining full disclosure

On this factor, the *Blinder* court found:

> There has been a full and fair opportunity for all affected persons to participate directly in the process of obtaining full disclosure of the matters involved in this settlement agreement. The mailed notices gave an accurate and adequate summary of the terms and conditions of the settlement. The settlement documents have been available for public inspection in the office of the Clerk. No formal method of making objections was required. Participation at the hearing was invited, without limitation, and the settling defendants appeared at the hearing prepared to respond to any relevant inquiries and to produce relevant documents.

511 F. Supp. at 802.

Such due process standards were observed here as well. While the parties were still negotiating the Settlement Agreement, investors had access to the data room filled with financial and business information, upon their execution of court-approved confidentiality agreements. [*See* SL, D.E. 248 at 19-20; *see also* SL, D.E. 279 at 16-17].

In addition, in the Joint Motion to Approve the Settlement Agreement, the parties attached and described in detail the proposed Settlement Agreement [SL, D.E. 248 at 10-18] and explained they were seeking Court approval to have the entities transferred to FP Designee, whose interests would be distributed to investors *via* the claims process, pursuant to the exemption to registration in Section 3(a)(10) of the Securities Act of 1933. [SL, D.E. 248 at 3, 19]. The parties also attached, among other things, an estimated calculation of value by the Receiver's accounting firm, Berkowitz Pollack & Brant, and other materials. [SL, D.E. 248-4].

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was partially overruled. The Archdiocese "opted out" of the Settlement Agreement by not submitting an investor release. The Archdiocese did not object to the Receiver's Claims Submission.

Upon the Court's preliminary approval of the Settlement Agreement, the Receiver provided all investors with a package of information, including a notice, the Joint Motion and confidentiality agreement for the investors to obtain more due diligence. [SL, D.E. 255] Those investors who submitted the proper confidentiality agreements received reports by the professionals who conducted due diligence, an investment banker's report, and audited financial statements, and other highly confidential information. [SL, D.E. 279 at 19-22].

Unlike *Blinder*, here the Court provided a formal objection procedure. The investors were given an opportunity to object, and many did object, as noted above. Investors were permitted to appear at the hearing on the approval of the Settlement Agreement alongside counsel for the parties, all of whom were given a full opportunity to make their arguments and direct pointed questions to the parties.

Further, those investors who are members of the Investor Group (as defined in previous filings) had additional direct participation in the process, as noted.

Thus, the investors -- who have been on notice that the Receiver would seek to use the Section 3(a)(10) exemption since at least the Joint Motion for Approval of the Settlement Agreement filed on December 9, 2011 [SL, D.E. 248 at 3, 19] – plainly have had ample opportunity to directly participate in the process of evaluating the Settlement Agreement, satisfying the fifth and final element of the *Blinder* test.[7]

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[7] Since the hearing on Court approved the Settlement Agreement, and with leave of the Court, the Receiver appointed his proposed slate of directors, the parties closed the transaction, and FP Designee and/or its subsidiaries have continued to operate and engage in business activities and transactions, under their governing structures. Among other things, the FP Designee (and/or its subsidiaries) has: (1) entered into a transaction with a third-party property owner to lease facilities, and executed an operations transfer agreement with the prior operator of six facilities – four long-term acute care facilities and two skilled nursing facilities; (2) exercised an option to purchase a Missouri facility within which it already operates; (3) funded construction of two facilities for which it had obtained certificates of need, which certificates were discussed in the settlement papers; (4) closed an agreement for an approximately $49 million line of credit; (5) executed installment and subordination agreements with the Internal Revenue Service; (6) executed agreements with key management; (7) amended the limited liability company agreement; (8) considered other amendments to its governing documents; and (9) engaged in other

II. The Receiver's Position On The Form Of Order

The Receiver seeks to distribute ownership interests in FP Designee to all eligible claimants in accordance with the Receivers' Motion for Court Approval of: (a) the Receiver's recommendations concerning claims; (b) An Interim Distribution of Interests in the FP Designee; and (c) the Receiver's Proposed Objection Schedule. [D.E. 395]. To effectuate this, the Receiver respectfully requests that the Court enter an order authorizing FP Designee to record in its books and records the membership interests reflected in Schedule B, Column 5 to the Receiver's Response to Objections [D.E. 417 at Schedule B] without the need for the filing of a registration statement in accordance with Section 3(a)(10) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(10). Further, the Receiver respectfully requests that FP Designee be authorized to bestow such rights upon such members in accordance with Delaware law and its governing documents, as amended and as may be amended.

CONCLUSION

For these reasons, and with the consent of the SEC and the Sun Entities, the Receiver seeks an order: (1) approving the distribution of membership interests in FP Designee (based on the Court's rulings on the Receiver's Claims Submission), without the need to file a registration statement, pursuant to Section 3(a)(10) of the Securities Act of 1933, and (2) using the form of order set forth herein.

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transactions, operations, and actions in connection with its business operations. If requested by the Court at the hearing, the Receiver will review those and other events.

CERTIFICATE OF SERVICE

I hereby certify that on June 6, 2014, I electronically filed the foregoing document with the Clerk of the Court using CM/ECF. I also certify that the foregoing is being served this day on all counsel of record identified on the attached Service List in the manner specified, either via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel who are not authorized to receive Notices of Electronic Filing.

Dated: June 6, 2014.

Respectfully submitted,

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