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**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE NORTHERN DISTRICT OF TEXAS**
**FORT WORTH DIVISION**

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| IN RE | § | |
| | § | CASE NO.: 15-40289-RFN |
| LIFE PARTNERS HOLDINGS, INC. | § | |
| | § | CHAPTER 11 |
| DEBTOR. | § | |

**REPLY TO SECURITIES AND EXCHANGE COMMISSION'S OBJECTION TO CERTAIN SHAREHOLDERS' MOTION FOR RECONSIDERATION OF SPECIFIC FINDINGS OF FACT AND CONCLUSIONS OF LAW IN ORDER GRANTING THE MOTION FOR APPOINTMENT OF A CHAPTER 11 TRUSTEE**

## I. Introduction

This brief replies to the objections of the Securities and Exchange Commission (SEC) to the Certain Shareholders' motion to modify specific findings of fact and conclusions of law adopted by the Court's March 10 order. In those findings, the Court was critical of the Debtor's filing of an SEC Form 8-K (8-K) describing the possible risks to investors if the Court appointed a Chapter 11 Trustee. The SEC has argued the proposed documentary evidence (1) is consistent with the findings in issue; (2) is hearsay; (3) is not new evidence and does not correct a manifest error of fact. The SEC also contends the motion would have been "more appropriately [brought] under Fed. R. Civ. P. 52(b)." We address and refute each point below.

The SEC questions why we did not ask the Court to vacate its order.[1] Simply, put, there is insufficient information regarding the newly appointed Trustee to make that decision. However, the Certain Shareholders have not renounced their rights to appeal that order.

## II. The True Narrative Told by the Emails between the Participants

### A. The Circumstances Which Led to the Filing of the 8-K

The SEC's objection elevates form over substance in arguing the only issue is who proposed the filing of the 8-K. We believe the Court was focusing on substantive issues: (1) who first described the risks the appointment of a Chapter 11 Trustee would have on holders of fractional interests in life settlements (FILS), (2) who first proposed the disclosure of those risks, and (3) who decided what disclosures to make. The proposed documents are the very communications in issue. They begin with a series of emails on February 11, which include the chilling analysis by the Debtor's counsel, Gerrit Pronske (Pronske), of the risks the appointment of a Chapter 11 Trustee would have for shareholders, FILS holders, and the Debtor.

[1] The SEC also claims the Certain Shareholders' counsel is defending himself, but the Court made clear this was unnecessary. Reporter's Transcript, March 9, p. 28, l. 11-p. 29, l. 9.

**1. The Pronske Email: the Creation of Material Nonpublic Information by the Debtor**

On February 11, Pronske sent an email that predicted a scenario which would result in FILS holders receiving cents on the dollar. Pronske explained:

> The Bankruptcy Code, section 541(a)(l), says that "property of the estate" is defined as any legal or equitable interest of the Debtor in property. A Trustee would claim that the policies are property of the estate under section 541(a)(l), and that the fractional interest holders' positions are "avoidable." These policies would then be owned by LPI, which they would claim is the alter ego of LPHI. Or, alternatively, as the 100% owner of LPI, the Trustee of LPHI would put LPI into its own Chapter II bankruptcy case and move to substantively consolidate the 2 companies under bankruptcy case law that allows for such a procedure by motion. There are questions that the Creditors' Committee attorney asked of Colette Pieper that seemed to be directly on point to this theory, and in furtherance of such a strategy.

See Exhibit 4 to Declaration of Colette Pieper[2] (Pieper Dec.), pp. 2-3.

In the same email, Pronske next explained how the $3 billion in life settlements could be included in the bankruptcy as LPHI assets:

> The legal fees in such a battle would be north of $10 to 15 million on each side. A Trustee would "manage" the portfolio for years and be paid substantial amounts of fees to himself and his law firm. During the process, the Trustee could file a Plan of Reorganization that would create a "Liquidating Trust," with a "Liquidating Trustee," to avoid the fractional interests, roll up the policies into a pool, and be paid substantial amounts of attorneys [sic] fees in the process. If the case against the fractional interest holders survived summary judgment, the fees for the Trustee and his law firm would be massive. This lawsuit would kill the ongoing business and insure a liquidation. Ultimately, fractional interest holders could receive only "cents on the dollar," as early policy maturities would likely go to centralized administrative claims for the Trustee and his team. It would take 10 years or more to liquidate and pay claims. This is similar to what the Receiver, Eddie Espinosa, did in the Retirement Value Receivership case - much different facts, but a similar strategy. Obviously this type of approach is a disaster for everyone except the Trustee and his law firm and any law firm that assists to take on the lawsuit against the fractional interest owners and funded by the cash and assets of LPI and LPHI.

Exhibit 4 to Pieper Dec., p. 3.

The Pronske analysis shocked all who read it. Brian Pardo (Pardo), then the Debtor's Chief Executive Officer, responded: "This is a truly scary angle!" (Exhibit 5 to Pieper Dec., p.

[2] The Pieper declaration was filed on March 19, 2015 (Dkt. No. 226-1).

1). Scott Peden (Peden), the Debtor's General Counsel, raised the obvious question whether the risks described in the Pronske analysis should be disclosed: "Should we not then warn our clients of the danger in their interests being essentially stolen by the Trustee?" (Exhibit 4 to Pieper Dec., p. 2). In response, Pronske stated the time was not yet ripe for disclosure: "We don't have any direct knowledge that would provide the basis for a warning." (Exhibit 4 to Pieper Dec., pp. 1-2).

Aguirre also viewed Pronske's analysis as a stark scenario for FILS holders. His response linked two potential developments: (1) life settlements becoming assets of LPHI through the bankruptcy and (2) the FILS being treated as an equity security. Aguirre replied: "This would logically mean that policy proceeds are assets of LPHI. Consequently, all fractional interest holders are equity investors and SEC judgment has priority." Exhibit 4 to Pieper Dec., p. 1.

And then Michael Quilling (Quilling) testified. On February 12, he testified how life settlement portfolios managed by LPI could be sold: "But the big boys that are going to play in this, and anybody big enough to buy Life Partners' portfolio, if that was an exit strategy, you've got to be real big to do that and you've got to have real sophistication to do it."[3] On February 17, Quilling testified how three of his prior cases had gone down a path similar to the one described by Pronske in his February 11 analysis. Quilling described a similar possible scenario for the life settlements managed by LPI.[4]

**B. SEC Regulation FD Triggered the Call for the Filing of an 8-K.**

The SEC conveniently ignores the clear application of the Exchange Act and Regulation FD (Reg FD) to the events in February, a point we addressed in our opening brief.[5] The February

[3] Feb 12 Tr., p. 203, ll. 1-4

[4] Feb 17 Tr., p. 16, l. 22--p. 17, l. 3; p. 19, ll. 15-17; p. 23, l. 9--p. 24, l. 3; p. 24, l. 13--p. 25, l. 11; p. 45, ll. 16-24.

[5] Certain Shareholders' Motion to Reconsider Specific Findings of Fact and Conclusions of Law (Dkt No. 237, pp. 4-7; see also Aguirre Declaration (Dkt. No. 237-1), ¶ 11.

11 analysis by Pronske, LPHI's highly experienced and competent bankruptcy counsel,[6] had huge potential for moving the market prices of the stock and the FILS. It also created an environment ripe for inadvertent or even intentional violations of the securities laws.

The uncertainty of this scenario did not affect its materiality. The guidelines for assessing the materiality of uncertain events were articulated in *SEC v. MacDonald*, 699 F.2d 47, 50 (1st Cir. 1983):

> The materiality of facts regarding a contingent future event is simply a function of the anticipated magnitude of the event if it occurs, discounted by the probability of its occurring....A 'reasonable, if speculative, investor' would consider information indicating even the possible occurrence of an event of magnitude to be important....Here, the future event was sufficiently large to remain material even discounting for whatever uncertainty may be thought to have existed.

See also: *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (U.S. 1988)([M]ateriality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.")

Likewise, the fact Pronske and the Debtor concluded the information was not ripe for disclosure on February 11 did not affect its materiality. The Supreme Court in *Basic Inc.* explained, "But, if for valid reasons, a corporation does not deem material information ripe for public disclosure, so that disclosure by the insider would be a breach of fiduciary duty, the insider must refrain from dealing in the corporation's securities in the interim." (485 U.S. at 238)

The information was also nonpublic and came from the issuer, the Debtor, through its attorney (Pronske) in this case. Acting on behalf of the Debtor, Pronske disclosed his analysis to five people with an expectation of confidentiality under the joint defense extension of the attorney-client privilege. Consequently, the selective disclosure of this information by anyone of

[6] See http://www.pgkpc.com/thefirm_team/geritt-m-pronske/.

the five individuals to security holders in LPHI, i.e., either shareholders or FILS holders, could constitute a violation of Section 13(a) of the Securities Exchange Act of 1934 and Reg. FD. See: *In the Matter of Polizzotto*, 2013 SEC LEXIS 2660 (SEC 2013).

The possible violation of Section 13(a) and Reg. FD was at the low end of the risk scale. If shareholders or FILS holders obtained information about the Pronske analysis and traded on it, the trades were potentially insider trading, a violation of Section 10b and Rule 10b-5. In such a case, both tipper and tippee may face civil or criminal liability. *United States v. Corbin,* 729 F. Supp. 2d 607, 612 (S.D.N.Y. 2010)

The risks to anyone who received the Pronske analysis were further complicated by the nature of insider trading investigations. Those violations are usually established through circumstantial evidence. See: *SEC v. Roszak*, 495 F. Supp. 2d 875, 887 (N.D. Ill. 2007)(drawing an inference of insider trading from circumstantial evidence). Put differently, if any FILS holder or shareholder learned of the material nonpublic information and traded on it, any government investigation would likely focus on connections between the trader and those who had knowledge of the information: the five individuals who received the Pronske analysis. On top of this, the SEC now pursues insider trading cases to the extreme, a subject Aguirre has written about.[7] Indeed, in *SEC v. Life Partners*, the SEC unsuccessfully pursued claims for insider trading against both Pardo and Peden.

For an attorney representing investors, the rules of professional conduct impose a duty in tension with Reg FD prohibitions. Those professional rules require an attorney to inform his

[7] *A Tale of Two Frauds: Part I; the SEC, Insider Trading & an "Ideal Opportunity Squandered,"* Wall St Lawyer, Aug. 2013, Vol. 17, Issue 8, at http://aguirrelawapc.com/global_pictures/2013_Aug_Art_in_WSt _Lawyer.pdf.

clients about the status of the case and comply with requests for information.[8] A report was logically due Aguirre's 61 clients (including 14 FILS holders) on February 19 when the motion was submitted. The obvious solution was a simultaneous fair disclosure under Reg FD of the material facts to all FILS holders and shareholders. The 8-K is specifically designed for such disclosures.[9] And that was exactly the stated reason in Aguirre's February 21 email to the Debtor's counsel suggesting the disclosure of the risks.[10]

**C. A Comparison of Aguirre's February 21 Email and the 8-K Corroborates Berman's Testimony He Independently Drafted the 8-K.**

Berman repeatedly testified at the March 3 hearing that he independently drafted all of the statements in the 8-K,[11] with the exception of a comment he took from Aguirre's email relating to the U.S. Trustee. There was also an ambiguity in his testimony: whether Aguirre's email directed Berman to any specific testimony by Quilling.[12] It did not. It referred Berman to the entire cross and re-cross examinations.[13] Berman read both transcripts.[14]

Berman's testimony that he independently wrote the 8-K is corroborated by a comparison of the text of the 8-K with Aguirre's February 21, 2015, email. By our count, the 8-K makes approximately 50 specific factual statements. It describes numerous specific excerpts from Quilling's testimony; Aguirre's email contains no such references. The 8-K describes in detail the events which could occur if the trustee pools the life settlements; the Aguirre email contains

[8] See: ABA Model Rule 1.4(a) "A lawyer shall: ... keep the client reasonably informed about the status of the matter; [and] (4) promptly comply with reasonable requests for information ..."; California Rule of Professional Conduct 3.500; and Texas Disciplinary Rules of Professional Conduct 1.03 Communication.

[9] See 8-K template, available at http://www.sec.gov/about/forms/form8-k.pdf. Reg FD is mentioned 12 times in the template. See pp. 1, 2, and 21.

[10] Aguirre's Feb. 21, 2015, email to Berman specifically referred to his concerns regarding the selective disclosure of material nonpublic information to securities holders, the conduct prohibited by Reg FD. See Ex. 4 to Aguirre Decl. (Dkt. No. 237-5).

[11] March 3, 2015, R. Tr., p. 86, l. 25 to p. 87, l. 2; p. 87, ll. 18-20; p. 98, l. 25 to p. 99, l. 3; p. 79, l. 9- 25; p. 99, ll. 13-20; p. 102, l. 25 to p. 103, l. 11.

[12] *Id*, R. Tr., p. 87, l. 21 to p. 88, l. 4; p. 88, ll. 5-7.

[13] See Ex. 4 to Aguirre Decl. (Dkt. No. 237-5).

[14] March 3, 2015, R. Tr., p. 88, ll. 5-7 and p. 100, ll. 2-3.

no such statements. Likewise, the Aguirre email made no comment on either of the statements the Court found troubling during the March 3 hearing relating to the likelihood that a Trustee would be appointed or the Trustee could pool the life settlements without notice. (Tr. pp. 75-76)

Aguirre's February 21 email had a substantially different focus than the 8-K. Aguirre summarized his concerns: "Putting this all together, I can see a significant risk that the fractionalized interest holders would be treated as equity interest holders." Significantly, this is the same concern Aguirre expressed after receiving the Pronske analysis on February 11: that FILS holders would effectively be treated as shareholders. This is the same concern Aguirre articulated to the Court during the February 17 hearing, when he told the Court he was concerned about a new "preferred shareholders" group.[15] The 8-K made no reference to this theory.

A comparison of Pronske's February 11 analysis with Aguirre's email of February 21 to Berman demonstrates Aguirre's was moderate in tone and content and general—not specific—in comparison with Pronske's description of the same risks. And the Aguirre email did not invite Berman to accept those statements. Rather, it submitted the entire February 17 transcript along with this statement: "I therefore submit this information to you so you can decide whether the company has a duty to disclose this risk to shareholders and possibly to the investors in the life settlements/viaticals."[16] And Berman testified he read the transcripts of Quilling's testimony before he prepared the 8-K.[17]

The SEC's objections concede there is little correlation between the 8-K and Aguirre's email. It argues seven different ways that Aguirre suggested the idea of the Form 8-K to

[15] Feb 17, 2015, R. Tr., p. 191, l. 20 to p. 192, l. 5.
[16] See Ex. 4 to Aguirre Decl. (Dkt. No. 237-5).
[17] March 3, 2015, R. Tr., p. 80, ll. 1-21; p. 86, ll. 17-19; and p. 100, ll. 2-3.

Berman,[18] but cites no language from Aguirre's email that was incorporated into the 8-K except the reference to the US Trustee. And the SEC cites this language—relating to the US Trustee—five times.[19]

And then there are the established facts the SEC ignores: The language that troubled the Court in the 8-K related to the 8-K description what had or would happen in the bankruptcy proceedings.[20] The last attorney to see and approve the 8-K, the press release, and the letter to FILS holders was Pronske.[21] He twice sent texts to Pieper approving the language in all three documents.[22] Aguirre states under oath he never saw the 8-K or participated in its drafting.[23] Pieper states under oath she never discussed it with Aguirre.[24] We submit the Debtor and Pieper reasonably relied on the advice of its bankruptcy counsel in this highly technical legal specialty.

**D. There Are Grounds for Modifying the Court's Findings under Both Rules, 59 and 52**

We urge two grounds for modifying the Court's findings: (1) new evidence has become available and (2) to correct a manifest error of fact. These grounds are available under both Rule 59, *Bivins v. United States*, 2014 U.S. Dist. LEXIS 105548 (N.D. Tex. 2014)) and Rule 52, *AT&T Mobility P.R. Inc. v. Pulsar P.R. Inc.*, 2013 Bankr. LEXIS 4351 (Bankr. D.P.R. 2013). Whether evidence qualifies as new evidence depends on whether it was available at trial. See: *In re Balt. Behavioral Health, Inc*., 2014 Bankr. LEXIS 4068 (Bankr. D. Md. Sept. 23, 2014); *Sanders v. Bell Helicopter Textron, Inc.*, 2005 U.S. Dist. LEXIS 46920 (N.D. Tex. Oct. 25, 2005). The new evidence was unavailable under the attorney-client privilege until March 11, when Pieper waived it. Pieper Dec. ¶ 3. The documents did not even become relevant until the

[18] SEC Objection (Dkt. No. 242), pp. 5-6 and fn. 3.
[19] *Id*, p. 6 and fn. 3.
[20] March 9, 2015, R. Tr., p. 23, l. 2 to p. 24, l. 2.
[21] Pieper Decl., ¶ 10.
[22] *Id*, Exhibit 7.
[23] Aguirre Decl. (Dkt No. 237-1) ¶¶ 9, and 12-14. See also March 3, 2015, R. Tr., p. 145, ll. 8-9.
[24] Pieper Decl., ¶ 9.

trial was reopened on March 3 when an issue arose spontaneously: when and why the Debtor became aware of the risks relating to the appointment of a trustee and who first suggested the disclosure of those risks. At the earliest, there was not a hint of any grounds to waive the privilege until Berman—the last witness—testified. But relevance does not mean waiver. The only theory—implied waiver—was speculative. Still, we brought a motion six days later seeking an order overruling the privilege on the implied waiver theory and asking the documents be admitted.[25] The Court heard the motion on March 9, overruled the objection to one document, but did not admit it. With the Debtor's waiver of the privilege on March 11, we respectfully submit this motion is the earliest this evidence could be presented to this Court. Finally, we submit the documents substantially change the record before the Court and thus create a manifest error in the findings which could easily be corrected.

## III. The SEC's Procedural Contentions for Opposing the Motion Are Groundless

### A. The Proposed Evidence Is Not Hearsay

Rule of Evidence 801(c) defines "hearsay" to be an out of Court statement "offered in evidence to prove the truth of the matter asserted." None of the documents are offered for this purpose. Rather, they are offered to prove the existence of the statements asserted, and consequently are not hearsay. *Tremont LLC v Halliburton Energy Servs.*, 696 F.Supp.2d 741 (SD Tex 2010)(where hearsay objection to document was overruled where document at issue was offered to show what arbitration panel heard, and not to prove truth of its contents.) Exhibits 4 and 5 to Pieper's Dec. are the email chains between Pronske, Peden, Buchanan, Pardo and Aguirre, in which Pronske articulates the risks the appointment of a Chapter 11 Trustee would have on the Debtor, its shareholders and FILS holders, Peden suggests a disclosure to FILS

[25] See Certain Shareholders' Emergency Motion (Dkt. No. 176).

holders, Pardo expresses his concerns as the CEO, and Aguirre expresses the risks he foresees to FILS holders. Exhibit 4 to the Aguirre Dec. (Docket No. 237-5) is Aguirre's February 21 email to Berman raising the issue whether these risks should be disclosed to shareholders and FILS holders. Exhibit 7 to Pieper's Dec. consists of the text messages between Pieper and Pronske confirming Pronske's approval, as bankruptcy counsel, of the 8-K, press release, and letter to FILS holders. These communications are the actual events which are the subject matter of the Court's findings in issue.

**B. The SEC's Contention that This Motion Would Be Better Brought as a Motion under Rule 52 Is Distinction without a Difference.**

Rules 52 and 59 have the same deadlines, grounds for bringing the motion, and effect in tolling the period for filing a notice of appeal. Both rules also permit the Court to modify its findings. See: Rule 52(b) and Rule 59(a)(2). We note that Rule 59(a)(1) provides the court may "grant a new trial on all or some of the issues ..." Rule 59(a)(2) also provides the Court "may ... take additional testimony." Rule 52 on its face does not authorize the Court to grant a new trial on any issue or hold an evidentiary hearing. Accordingly, we have sought relief under Rule 59, but submit the issue which rule best suits the requested relief to the Court's judgment.

Signed this 31st day of March 2015.

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Respectfully submitted,
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