Appeal No. 23-1870

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee

v.

KEVIN B. DUFF, RECEIVER,
Court-Appointed Receiver-Appellee

v.

BC57, LLC,
Appellant

Appeal from the United States District Court
for the Northern District of Illinois
Hon. Manish S. Shah
1:18-cv-5587

BRIEF OF APPELLEE-RECEIVER KEVIN B. DUFF

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Attorneys for Appellee Kevin B. Duff, Receiver

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APPEARANCE & CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 23-1870

Short Caption: SEC, et al., v. BC57, LLC

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party, amicus curiae, intervenor or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

The Court prefers that the disclosure statements be filed immediately following docketing; but, the disclosure statement must be filed within 21 days of docketing or upon the filing of a motion, response, petition, or answer in this court, whichever occurs first. Attorneys are required to file an amended statement to reflect any material changes in the required information. The text of the statement must also be included in the front of the table of contents of the party's main brief. **Counsel is required to complete the entire statement and to use N/A for any information that is not applicable if this form is used.**

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(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P. 26.1 by completing item #3):

Kevin B. Duff, Receiver for EquityBuild, Inc., EquityBuild Finance, LLC, and affiliates, and affiliate entities of Defendants Jerome Cohen and Shaun Cohen. A list of the entities in the Receivership is attached as Exhibit 1 hereto.

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Rachlis Duff & Peel, LLC

(3) If the party, amicus or intervenor is a corporation:

i) Identify all its parent corporations, if any; and

none

ii) list any publicly held company that owns 10% or more of the party's, amicus' or intervenor's stock:

n/a

(4) Provide information required by FRAP 26.1(b) – Organizational Victims in Criminal Cases:

n/a

(5) Provide Debtor information required by FRAP 26.1 (c) 1 & 2:

n/a

Attorney's Signature: /s/ Michael Rachlis Date: August 10, 2023

Attorney's Printed Name: Michael Rachlis

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** ☑ **No** ☐

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Phone Number: 312-733-3950 Fax Number: 312-733-3952

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Exhibit 1
List of the Entities in the Receivership

109 N. Laramie, LLC	8153 S Avalon LLC	South Side Development Fund 7 LLC
11318 S Church St Associates	8209 S. Ellis, LLC	South Side Development Fund 8 LLC
1422 E68 LLC	8214 Ingleside, Inc.	SSDF1 4520 S. Drexel LLC
1632 Shirley LLC	8217 Dorchester LLC	SSDF1 4611 S. Drexel LLC
1700 Juneway LLC	8311 S Green LLC	SSDF1 6751 S. Merrill LLC
2136 W 83RD LLC	8432 S Throop Associates	SSDF1 7110 S Cornell LLC
2537 N McVicker LLC	8725 S Ada LLC	SSDF1 Holdco 1, LLC
3400 Newkirk, LLC	8745 S Sangamon LLC	SSDF1 Holdco 2 LLC
400 S. Kilbourn, LLC	8801 S Bishop St Associates	SSDF1 Holdco 3 LLC
4520 S Drexel LLC	8809 S Wood Associates	SSDF1 Holdco 4 LLC
4520-26 S Drexel LLC n/k/a SSDF1 4520 S Drexel LLC	9158 S Dobson LLC	SSDF2 1139 E 79th LLC
4528 Michigan LLC	Amalgamated Capital Fund II LLC	SSDF2 Holdco 1 LLC
4533-37 S Calumet LLC	Amalgamated Capital Fund III LLC	SSDF2 Holdco 2 LLC
4611-17 S. Drexel, LLC	Chicago Capital Fund I LLC	SSDF2 Holdco 3 LLC
4750 Indiana LLC	Chicago Capital Fund II LLC	SSDF3 Holdco 1 LLC
4755 S Saint Lawrence Associates	Chief Management LLC	SSDF3 Holdco 2 LLC
5001 S Drexel LLC	EB 6558 S. Vernon LLC	SSDF4 6217 S. Dorchester LLC
5411 W Wrightwood LLC	EB Property Holdings LLC	SSDF4 6250 S. Mozart LLC
5450 S. Indiana LLC	EB South Chicago 1 LLC	SSDF4 638 N Avers LLC
5618 S MLK LLC	EB South Chicago 1 Manager, LLC	SSDF4 701 S 5th LLC
5955 Sacramento, Inc.	EB South Chicago 2 LLC	SSDF4 7024 S Paxton LLC
6001 Sacramento, Inc.	EB South Chicago 2 Manager, LLC	SSDF4 7255 S. Euclid LLC
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n/a

Attorney's Signature: /s/ Jodi Rosen WIne Date: August 10, 2023

Attorney's Printed Name: Jodi Rosen Wine

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** ☐ **No** ☑

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JURISDICTIONAL STATEMENT

The Receiver does not have any comment or statement in regards to jurisdiction.

STATEMENT OF ISSUES

Did the District Court abuse its discretion in approving the Receiver's proposed distribution plan and methodology?

Did the District Court abuse its discretion in ruling that the investor lenders have priority over BC57 where it determined that BC57 failed to meet its burden of proof in regards to the salient factual issues below including, *inter alia,* (i) whether a scrivener's error existed that should be overlooked to find that the investor lenders' mortgage interests had been released, (ii) whether EquityBuild Finance, LLC an entity controlled and used by the Cohens to perpetrate their fraud, had actual or apparent authority to release the investor lenders' interests, and (iii) whether payment indisputably not being made to, or received by, the mortgagees (*i.e.,* the investor lenders)—but instead to an entity related to the borrower—could nevertheless trigger an automatic release of their mortgage interests under the Illinois Mortgage Act?

STATEMENT OF THE CASE

A. The Ponzi Scheme.

Father and son, Jerome Cohen and Shaun Cohen, owned and controlled EquityBuild, Inc., EquityBuild Finance, LLC, and numerous affiliated entities which owned and operated various real estate holdings, principally on the southside of Chicago. [Dkt. 1 at 1] The Cohens claimed that they had a method to locate undervalued property and solicited loans and investments with promises of large returns. [*Id.* at 1-2] But the business was a massive fraud. [*Id.*] The Cohens were operating a Ponzi scheme and violating federal securities laws which involved, *inter alia,* over-inflating the values of properties to make them attractive to lenders and investors, creating multiple secured interests in the same properties, and taking various other actions to ensure they received fresh monies to pay the obligations to various lenders and investors needed to keep the scheme alive. [*Id.*]

The United States Securities and Exchange Commission commenced this action on August 15, 2018 to stop the Defendants' scheme and securities violations. [*Id.* at 3] A consent judgment was entered a short time thereafter. [Dkt. 40] The SEC sought and the

District Court appointed a receiver to take charge of EquityBuild's business and assets. [Dkt. 16]

The receivership is complex and substantial, involving 108 real estate properties,[1] more than 1,600 residential units, and over 2,000 claims exceeding $100,000,000 submitted by about 841 claimants. [*See, e.g.,* Dkt. 638 at 8, 18-20; Dkt. 720 at 1; Dkt. 107 at 10] Maintenance, preservation, and orderly disposition of the properties and the proceeds from their sales has been a primary and substantial focus of the Receiver. [*See, e.g.,* Dkt. 107, 258, 348, 467, 567, 624, 698, 757, 839] Most of the properties were multi-family residential buildings in various states of repair and disrepair. [*See, e.g.,* Dkt. 107 at 21-22; Dkt. 348 at 9-12; Dkt. 638 at 3] The COVID-19 pandemic, and its impact on the economy in general and rental income and risk to the real estate market in particular, heightened the challenges of maintaining and preserving these properties. [*See, e.g.,* Dkt. 699 at 4]

EquityBuild's records, debts, and the assertions of its lienholders have shown that central to the Cohens' fraud was purposeful confusion

[1] When certain adjacent properties are counted separately, the number of properties is 116.

and obfuscation of secured interests and the use of inflated property values. [*See, e.g.,* Dkt. 348 at 19; Dkt. 720 at 1; Dkt. 749 at 3] The Cohens would, for example, offer the same lending opportunity twice, telling each lender they were in first position. [*E.g.,* Dkt. 638 at 4] The Cohens' scheme resulted in mortgages on properties that in the aggregate were sometimes multiples of the actual value of the properties. [*Id.*] The Cohens created a labyrinthian network of over 158 separate corporate entities as cover for their activities. [*See* Dkt. 241 at 3] And at the heart of this complexity are competing, purportedly secured, claims asserted by both institutional lender claimants and investor lender claimants against properties in the estate. [*See* Dkt. 757, Exhibit 8; *see also* Dkt. 693, Exhibit 1 (claims organized by property)]

B. The Claims Review Process.

Given the number of claimants, properties, and disputes among those who claimed to have first priority interests, the Court went through a lengthy and detailed procedure to develop a summary process allowing for the review, discovery, and resolution of claims which would be divided into groups (largely based upon a common institutional lender). [Dkt. 638, 863, 938, 940, 941 (orders establishing components of claim process)]

C. The Group 1 Claims Process.

The first group ("Group 1") involved claims asserted against five properties: 3074 Cheltenham (Property 74); 7625-33 S East End (Property 75); 7635-43 S East End (Property 76); 7750 S Muskegon (Property 77); and 7201 S Constance (Property 78). There were 169 claimants in Group 1 who submitted proof of claims forms. [Dkt. 1004, 1006 (order and framing report for Group 1)] All Group 1 proof of claim forms and supporting documents were produced to each claimant in Group 1 and all EquityBuild records (in excess of 1.1 terabytes in volume) were produced and made available to all claimants. [Dkt. 941 at 4; Dkt. 1004 at 3]

Additionally, as part of the approved claims process, written and oral discovery was exchanged between the Group 1 participants. Depositions were taken of personnel and agents of Appellant BC57 (the institutional lender asserting priority in regards to all five properties) and some investor lenders, and expert testimony was also advanced by BC57. Documents and deposition testimony from the discovery process were submitted to the Court by the SEC, as well as various claimants

including BC57 and certain investor lenders. [Dkt. 1140, 1144, 1149, 1146, 1151, 1152-1159, 1168, 1195]

For his part, the Receiver and his retained professionals reviewed each of the claims submitted, the discovery identified above, and the position statements submitted by Group 1 claimants to make his recommendations on the validity of the claims, as well as the amounts claimed, consistent with goal of presenting a distribution plan for valid claims pursuant to which the District Court could order distribution of monies to claimants. Additionally, and pursuant to its February 9, 2021 Order, the Court directed the Receiver to make recommendations regarding priority. [Dkt. 941]

Consistent with Court's instructions and the duties of the Receiver, the Receiver provided recommendations on priority and on proposed distributions. [*See* Dkt. 1201 and Exhibits 1-8 thereto] Such recommendations included for each of the five properties in Group 1, *inter alia*, the Receiver's recommendations in regards to whether each non-institutional lender claim is secured or unsecured and as to the maximum amount to be distributed to such claimant if funds are available. [Dkt. 1201]

With regard to the priority dispute between BC57 (*i.e.,* the institutional lender) and the investor lenders, the Receiver recommended that the Court find that the mortgages recorded by the investor lenders have priority over the later-recorded mortgage to BC57. [Dkt. 1201 at 2-3] The Receiver adopted and incorporated the arguments of the SEC on this issue [Dkt. 1146], as well as arguments of other claimants in support of that position [*e.g.,* Dkt. 1151]. Those submissions revealed that the recorded mortgages for the investor lenders associated with the Group 1 properties were first in time and not properly released. Further, there was no evidence that such investor lenders were paid off from the proceeds of the BC57 loan.

The Receiver also made various recommendations on validity of the claims and maximum amount of distributions to be made to claimants in Group 1 based upon the Court's ultimate resolution of the priority dispute. [Dkt. 1201 at 4-15 & Exs. 1-8 thereto] Most claimants in Group 1 sought amounts in addition to the return of the principal amounts that they provided to EquityBuild. For example, many claimants sought unpaid interest that has accrued after the establishment of the Receivership (whether it be termed contract interest or default interest).

Other claimants sought to recover various types of penalties and attorneys' fees. The Receiver recommended that none of those categories beyond return of principal be allowed (following appropriate setoff for amounts already returned to claimants in various forms) for numerous reasons not limited to the fact that each of the amounts in the property accounts for the five properties at issue in Group 1 was less than the principal owed to the claimants on the properties [*See* Dkt. 1201, Ex. 8]

The Receiver further based the rejection of such requests on the fact that the EquityBuild companies and portfolio operated as a Ponzi scheme where new investor monies were commingled and used to continue operations. That was alleged with specificity by the SEC in its Complaint, and the Cohens did not deny the Ponzi scheme, having entered into a consent judgment [Dkt. 40].[2] The testimony provided to the District Court in support of the motion for the establishment of the Receivership evidenced the Ponzi scheme, as did later testimony and the

[2] The existence of the Ponzi scheme was admitted by Shaun Cohen in a video sent to various investors shortly before the SEC Complaint was filed (a video that was provided to the Court as part of the evidence at the hearing on the temporary restraining order leading to the Order Appointing Receiver). Shaun Cohen stated, in part, that EquityBuild subsidized interest payments from new investments (the definition of a Ponzi scheme). [Dkt. 1, ¶ 63]

District Court's ruling in regards to the turnover of Jerry Cohen's Naples home. [*See, e.g.*, Dkt. 492 at 3-7 (magistrate judge ruling discussing Tushaus testimony); Dkt. 603 at 5-6 (affirming magistrate judge ruling; "the [District] court agrees with the magistrate judge's assessment of the hearing evidence, which 'show[s] that the funds used [to purchase the Naples Property] came from [i]nvestor monies tied to the Cohen's Ponzi scheme" (citing Dkt. 492 at 3-7, 10-14)] The District Court's later entry of a monetary judgment found that the Cohen's had been operating a Ponzi scheme. [*See* Dkt. 533 at 2 ("Accordingly, the Cohens began running a Ponzi scheme, using new investors' funds to pay earlier investors' interest payments." (citing Dkt. 1, ¶ 45)]

The Cohens' Ponzi scheme commingled funds and used new funds from investor and institutional lenders to pay principal and exorbitant profits in the form of interest to prior and existing lenders and investors which were not tied directly and exclusively to income generated by the real estate assets associated with their loans and/or investments. For this reason, the Receiver recommended that claimants' claims be set-off by the amount of all pre-receivership distributions that they received from EquityBuild in order to achieve a ratable distribution of remaining

assets among all of the defrauded investors. *See Donell v. Kowell*, 533 F.3d 762, 770 (9th Cir. 2008) ("The 'winners' in the Ponzi scheme, even if innocent of any fraud themselves, should not be permitted to 'enjoy an advantage over later investors sucked into the Ponzi scheme who were not so lucky.'") (citation omitted). Under the "netting rule," amounts transferred by the Ponzi scheme perpetrator to the investor are netted against the initial amounts invested by that individual. *Id.* at 771. And the fact that the claimants may be innocent victims does not change the analysis, as described by this Court in another Ponzi scheme case:

> The money used for the trades came from investors gulled by fraudulent representations. Phillips was one of those investors, and it may seem "only fair" that he should be entitled to the profits on trades made with his money. That would be true as between him and [the Ponzi scheme operator]. It is not true as between him and either the creditors of or the other investors in the corporations. He should not be permitted to benefit from a fraud at their expense merely because he was not himself to blame for the fraud. All he is being asked to do is to return the net profits of his investment—the difference between what he put in at the beginning and what he had at the end.

Scholes v. Lehmann, 56 F.3d 750, 757-58 (7th Cir. 1995).

The amounts included in the Receiver's recommendations [Dkt. 1201] were taken from the claimants' sworn proofs of claim, verified standard discovery responses, position statements which were reviewed

and gathered during the claims process, or other information available to all participants. No party identified a material dispute.

D. The District Court Determined that the Investor Lenders Have Priority.

On February 15, 2023, following extensive briefing, the District Court issued its priority determination ruling. [Dkt. 1386, attached to Appellants Appendix at A.1-30] In that ruling, the Court determined that the investor lenders have priority. A further discussion of that ruling is included in the Argument section below.

E. The District Court Entered a Distribution Plan for Group 1 Properties.

Consistent with the Court's ruling, the Receiver prepared and submitted a final distribution plan for the Group 1 properties (which was later amended to correct certain inadvertent errors). The Court entered that distribution plan (as amended) on May 3, 2023. [Dkt. 1451, included in Appellant's Appendix at A.31-49] The final distribution plan was consistent with the Receiver's recommendations [Dkt. 1201] in that amounts other than principal were disallowed, setoffs for prior amounts received were made, and certain claims were found to be invalid. The funds available for distribution from the Group 1 properties are

insufficient to pay the amounts claimed by both the investor-lender claimants, on the one hand, and BC57, on the other hand.

F. The District Court Did Not Address Issues Raised by the Receiver in Regards to Whether BC57 Was on Inquiry Notice of the Fraud Perpetrated by the Cohens.

Having determined that the investor lenders had priority, the District Court did not address the issues associated with whether, *inter alia,* BC57 was on inquiry notice of the Cohens' fraud and therefore its loan should be deemed unsecured. [*See* Dkt. 1118] The District Court found its resolution of the priority dispute between the claimants rendered it unnecessary to reach such issues. [Dkt. 1386 at 11-12]

SUMMARY OF ARGUMENT

The claim amounts and methodology in the Receiver's distribution plan have not been challenged. On the sole issue raised by Appellant BC57 – challenging the District Court's decision on mortgage priority – the District Court's legal determinations were sound and the factual findings underlying its judgment were supported by undisputed evidence and not clearly erroneous. The District Court's ruling deserves significant deference. Thus, the Group 1 ruling on claimant priority and the Receiver's proposed distribution should be affirmed.

STANDARD OF REVIEW

"Because the district court has 'broad equitable power in this area,' [this Court] reviews the [district] court's decision approving the distribution plan deferentially, for abuse of discretion." *Duff v. Central Sleep Diagnostics, LLC*, 801 F.3d 833, 841 (7th Cir. 2015) (citing *SEC v. Wealth Mgmt., LLC,* 628 F.3d 323, 332 (7th Cir. 2010)).

ARGUMENT

I. BC57 Has Not Challenged the Methodology and Calculations of the Receiver's Distribution Plan.

This appeal arises from the District Court's entry of a final distribution plan for Group 1 claimants. [*See* Opening Br. at 4 ("The objecting claimants appealed from the district court's priority and distribution order pursuant to the collateral order doctrine.")] The final distribution plan contained recommended distributions which were based on providing return of principal to those found to have a first priority secured interest. The District Court's distribution plan disallowed requests for anything beyond such principal, whether it be for interest, penalties, and attorneys' fees, well supported decisions given the circumstances created by the Cohens and their Ponzi scheme. The distribution plan approved by the District Court also treated amounts

previously received by the claimants purportedly as interest or bonuses as a return of principal.

This appeal does not challenge the distribution plan methodology approved by the District Court. Nor did any claimant object to the Receiver's recommendations before the District Court on the proposed claim amounts, calculations, or the elements of underlying such amounts. Such issues have been waived. *See, e.g., Kauthar SDN BHD v. Sternberg,* 149 F.3d 659, 668 (7th Cir. 1998) ("a party's failure to address a claim in its opening brief results in a waiver of that issue"); *Hackett v. City of South Bend,* 956 F.3d 504, 510 (7th Cir. 2020) ("An appellant who does not address the rulings and reasoning of the district court forfeits any arguments he might have that those rulings were wrong.").

The Receiver further notes, and solely in the alternative, that even if such matters are not deemed to have been waived (though in fact they have been waived before both the District Court and this Court), the circumstances and evidence provided firmly establish the propriety of the District Court's order. As explained in the Receiver's recommendations to the District Court, claims outside of principal, including but not limited to interest, attorneys' fees, penalties, and other forms of charges

are not recoverable under the circumstances of the Cohens' Ponzi scheme and the resulting receivership. [Dkt. 1201 at 4-15] *See, e.g., Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 163 (1946) ("The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings."); *see also Matter of Fesco Plastics Corp.,* 996 F.2d 152, 155 (7th Cir. 1993); 11 U.S.C. § 502(b)(2). One of the many purposes of the rule excluding such amounts from claims is that the courts are charged with preserving and protecting the estate for the benefit of all interests involved. *Vanston,* 329 U.S. at 163; *see also, e.g., SEC v. Capital Cove Bancorp LLC,* 2015 WL 9701154 at *12 (C.D. Cal. Oct. 13, 2015) (excluding interest promotes the orderly and efficient administration of the receivership estate for the benefit of all creditors) (citing *SEC v. Hardy,* 803 F.2d 1034, 1038 (9th Cir. 1986)); 11 U.S.C. § 506(b) (noting attorneys' fees cannot be recovered for properties that are underwater).

Accordingly, and irrespective and/or independent of the determination of the priority issue, there is no challenge to the Receiver's distribution plan and methodology. But even if there were, the distribution plan's methodology and the determination of claim amounts

were within the District Court's discretion to approve and must be affirmed. *See, e.g., SEC v. Huber*, 702 F.3d 903, 908-09 (7th Cir. 2012) ("The cases treat the receiver's choice among allocation schemes as one within the discretion of the district court to approve or disapprove, like other aspects of the administration of a receivership.").

II. The District Court Did Not Abuse Its Discretion in Reaching Its Priority Determination, a Decision Based on Numerous Factual Determinations Regarding Evidence from Claimants Obtained through the Claims Process.

As the District Court noted, a court presiding over a federal equity receivership has "broad discretion in approving a plan for distribution of receivership funds." [Dkt. 1386 at 2 (citing *Wealth Mgmt.*, 628 F.3d at 332; *SEC v. Enter. Trust Co.*, 559 F.3d 649, 652 (7th Cir. 2009))]

Here, the District Court used its discretion to implement a claims process to address and unwind an indisputably complicated web of deceit involving the purported granting of first position secured interests to numerous claimants. To allow those matters to be addressed, the Court approved and implemented a process where disputed issues of priority would be litigated through summary proceedings involving groups of similarly-situated claimants. As discussed, *supra,* the process allowed

for discovery and detailed submissions from the Group 1 claimants, and the District Court examined and evaluated the facts presented by the claimants, which included factual and expert testimony, in order to reach its decision. Nothing in BC57's opening brief challenges the sales process leading to the funds available for distribution, the establishment of the claims process and its related rulings, or the District Court's factual findings. The only ruling challenged on appeal is the District Court's *legal* evaluation of the facts presented during the summary proceedings to reach its determination of the priority question.

As demonstrated in the record below, the Receiver made a recommendation on priority (as the Court had instructed) that the Court determine that the investor lenders had priority, based on the record evidence presented by the SEC and certain investor lenders, as well as evidence that was developed in the record through the discovery process. Based on that record, and given the wide deference and discretion the District Court has in a federal equity receivership, the District Court neither made a clear error in its factual findings nor abused its discretion in applying those findings to the law.

No scrivener's error. On the issue of whether the releases were facially defective (*see* A.12-14), the Receiver disagrees with BC57 that the issue turns merely on a legal issue, but instead the District Court's ruling is based on its factual findings. Specifically, the Court found that EquityBuild was listed in the body of the releases as the releasing party, but the releases were executed by EquityBuild Finance. The District Court explained that "the importance of the discrepancy is that it's not clear who is claiming to release the mortgage." [A.12]

In this regard, there was substantial evidence before the District Court that BC57 received the payoff letters in question from loan applicant, EquityBuild, under circumstances that made clear they were not from some independent loan servicer. For example, the original drafts of the payoff letters, which were prepared at the direction of Tyler DeRoo (an EquityBuild employee), directed BC57 to send the payoff funds directly to EquityBuild (the borrower), and Mr. DeRoo instructed that those payoff letters be amended so that the funds go to EquityBuild Finance:

> We need Payoffs to be remitted to EBF not EB, **the optics aren't good**. Can you change the account name? It references EB in the top half and EBF in the bottom half, need it all to be EBF.

[Dkt 1146 at Ex. 38; Dkt 1151 at Ex. C (emphasis added)] This e-mail, including the remark that the "optics [weren't] good," was forwarded to BC57's real estate lawyers during the loan underwriting. [Dkt. 1146 at 8 & Ex. 38] And the same email chain forwarded to counsel indicates that EquityBuild told EquityBuild Finance the dollar amounts to use for the payoff quotes. *Id.*

Other evidence before the District Court on this question included the fact that the releases initially sent to BC57 were prepared for signature by Jerry Cohen, the principal of the borrowing entity (EquityBuild), and not for signature by the lenders (c/o EquityBuild Finance). [Dkt. 1227 at Ex. 12] BC57's lawyers specifically noticed this irregularity and admonished that "[a]ll releases must be signed by EquityBuild Finance LLC and not Jerome Cohen individually." [Dkt. 1146 at Ex. 37; Dkt. 1151 at Ex. B] At a minimum. these facts demonstrate conclusively that EquityBuild and EquityBuild Finance were one and the same, and that the payoff letters and releases were in fact coming *from the borrower* and not a third-party loan servicer. The District Court did not err in rejecting BC57's attempt to pass this evidence off as a mere scrivener's error.

The District Court's finding in this regard was not an abuse of discretion. The Court found that BC57 failed to provide "any evidence from EquityBuild or EquityBuild Finance—let alone evidence that is 'clear, precise, convincing and of the most satisfactory character'—to show that they intended for EquityBuild Finance to be listed in the body . . . [t]hat sort of evidence about the parties' intent is required to find a scrivener's error, and it's the burden of the party asserting a scrivener's error to provide it." A.12-13 (citing *Young v. Verizon's Bell Atl. Cash Balance Plan*, 667 F. Supp. 2d 850, 894 (N.D. Ill. 2009), *affirmed*, 615 F.3d 808 (7th Cir. 2010)).

BC57's arguments on this issue (Opening Br. at 42-44) do nothing to move the needle, let alone rise to the level needed to establish an abuse of discretion. In that regard, BC57 recasts this issue as a "mutual mistake," but concedes that evidence showing the intention of the parties is still required. (*Id.* at 42, citing *Wheeler-Dealer, Ltd. v. Christ*, 379 Ill. App. 3d 864, 869 (1st Dist. 2008)) However, BC57 does not – and cannot – point to any evidence from EquityBuild or EquityBuild Finance, the two parties to the releases, reflecting either parties' intent. Any attempt to do so now would be pure speculation. Furthermore, this mutual

mistake argument was never presented to the District Court, and thus has been waived. *See Kauthar,* 149 F.3d at 668; *Hackett,* 956 F.3d at 510. Regardless, the District Court's factual findings that BC57 did not meet its burden to present convincing evidence of the parties' intent applies equally to BC57's new mutual mistake theory.

Based on the record evidence before it, the District Court appropriately found that BC57 did not meet its burden to present evidence necessary to establish a scrivener's error. [A.12-13] As such, BC57 fails to establish that the District Court erred in its factual findings or abused its discretion in determining that the releases were invalid.

No actual or apparent authority. The District Court also undertook a detailed analysis of the facts germane to the question of EquityBuild Finance's authority or lack thereof from various documents and records submitted by the SEC and various claimants. [A.14-28] To that end, and as this Court has previously recognized in applying Illinois law, "[t]he existence and scope of an agency relationship are questions of fact to be determined by the trier of fact." *Orix Credit Alliance, Inc., v. Taylor Machine Works, Inc.,* 125 F.3d 468, 474 (7th Cir. 1997) (affirming trial

court determination of no actual authority, no apparent authority, and no implied or inherent authority).

The District Court determined that the facts established that EquityBuild Finance did not have either the actual or apparent authority to release the investor lenders' mortgages. Consistent with this Court's holdings, the District Court performed a factual inquiry, because it is undisputed that the releases at issue did not contain the signatures of the individual investor lenders. The District Court examined the Collateral Agent and Servicing Agreement ("CASA") and the so-called "Authorization Document,"[3] and concluded that EquityBuild Finance could not unilaterally release the mortgages without the consent of the mortgagee investor lenders as those documents expressly precluded any such efforts. [Dkt. 1368 at 15-18] Similarly, the District Court concluded that the terms of the Authorization Document were not met because there was no payment in full to the mortgagees (*i.e.*, the individual investors who were listed expressly on recorded documents) [*id.* at 20],

[3] BC57 created this "Authorization Document" label, though the document cited (*i.e.*, R.1160 at 78) lacks any clear title. For the Court's benefit, the Receiver uses the same term, but does not concede the label makes any substantive difference.

and that the interpretation advanced by BC57 made superfluous other provisions from the CASA which was a part of the same transaction [*id.* at 21-24]. Accordingly, the District Court's disposal of the actual authority issue was neither an abuse of discretion nor contrary to law.

The District Court further determined that EquityBuild Finance did not have the actual or apparent authority to execute such releases without the consent of the investor lenders. [Dkt. 1368 at 24-28] In this regard, it is important to note that the SEC, certain investor lenders, and BC57 all submitted evidence before the District Court on the issue of the reasonableness of BC57's contention that the individual investors consented to the release. This inquiry involved questions of what BC57 knew or should have known, and required an examination of the diligence of BC57 in underwriting its loan. [Dkt. 1152-1159] Specifically, the District Court weighed the evidence as to whether BC57 used "reasonable diligence and prudence to ascertain whether the agent is acting and dealing with him within the scope of his powers." [A.25 (citing *Gen. Refrigeration & Plumbing Co. v. Goodwill Indus.*, 30 Ill. App. 3d 1081, 1086 (5th Dist. 1975) (quoting 3 John Bourdeau, et al., Am. Juris. Law of Agency (2d ed.)); *Malcak v. Westchester Park Dist.*, 754 F.2d 239,

245 (7th Cir. 1985) ("A third party dealing with an agent has the obligation to verify both the fact and extent of the agent's authority."))]

The District Court found that the evidence on this point was substantial, including but not limited to: (i) BC57's admission that it did not have copies of the CASA or Authorization Document during the loan process; (ii) BC57's employees admitted that they did not review such documents, nor even the recorded mortgages, nor payoff letters [Dkt. 1146 at 3, 7-10; Dkt. 1147-26 (J. Jarjosa Dep. Tr.); Dkt. 1151 at 11-16]; and (iii) BC57's seeming declination of any responsibility at all. [Dkt. 1146 at 7-10; Dkt. 1151 at 11-16] The District Court's finding that this was a "lax review" is well-supported in the record. [A.28] BC57and *amicus curiae* Illinois Land Title Association ("ILTA" or "Amicus") cite to various cases, which decisions were themselves addressed and distinguished by the District Court. [*Compare* Opening Br. at 31-41 & Amicus Br. at 9-14 *with* A.14-28]

Furthermore, the District Court's determination of the scope of an investigation is precisely the type of "question of what is reasonable under particular circumstances [which] is normally a question of fact." *See Horizon Fed. Sav. Bank v. Selden Fox & Associates,* 1989 WL 135377

(N.D. Ill. Oct. 13, 1989) (discussing obligations of investors in securities fraud matters: "Ordinary prudence requires a reasonable investor under certain circumstances to investigate," citing *Teamsters Local 282 Pension Trust Fund v. Angelos,* 839 F.2d 366, 371 (7th Cir. 1988)). Again, on this point, BC57 has not shown that the District Court's factual findings were clear error or otherwise an abuse of discretion.

ILTA takes issue with the District Court's weighing of the evidence presented with respect to industry custom and practice, arguing that it is not "blindly trusting" for a lender to accept—without question or any investigation or even reviewing—payoff figures and releases from the borrower and not from an independent loan servicer. [Amicus Br. at 14] To support that view, ILTA tries to justify the "custom and practice" evidence, which the District Court describes as too lax and sloppy, by arguing that it is "premised on legal obligations imposed upon servicers not only in their servicing agreements, but under the law." [*Id.*] ILTA's and BC57's arguments in this regard are immensely problematic, which the District Court's statements and findings recognized. [A.26-28]

ILTA's "custom and practice" arguments are themselves largely irrelevant because they come from an organization "whose mission is to

provide professional education and government advocacy to companies in the business of insuring titles." [Amicus Br. at 1] As the District Court noted, the custom and practice of title insurers is beside the point because a title insurer is not in the business of supplying information, and thus BC57 could not rely upon the title insurer for its review. [A.27]

But beyond that point, ILTA's argument that the District Court opinion's impact will be significant on custom and practice, were it accurate, actually is a reason to favor affirmance. It makes no sense to defend as proper a custom or practice that encourages and condones the sloppy conduct at issue here. Indeed, for example, the District Court noted the admission that BC57 (and by implications others) "could have easily made the loan contingent on being able to contact the existing lenders to verify EquityBuild Finance's release authority." [A.28]

Relatedly, ILTA's argument that this process is premised on legal obligations is also inaccurate. There is no law that provides (or should provide) that BC57 can act without diligence or reasonableness in such dealings under the facts and circumstances at bar, including the fact that the parties holding the prior secured interests to be released are expressly identified in the recorded documents. To this point, BC57's

Opening Brief does not even squarely address the District Court's findings regarding apparent authority, and as such any challenge to those apparent authority rulings has been waived. *See Kauthar,* 149 F.3d at 668; *Hackett,* 956 F.3d at 510. While BC57 and ILTA are not concerned, as a matter of self-interest, about EquityBuild Finance's contractual obligations or its authority to unilaterally release the investor lenders' pre-existing mortgage interests, the District Court inquiry shows factually and legally why such review is critical.

No automatic release by payment. The arguments now advanced by BC57 that such releases are enforceable because payment was made to EquityBuild Finance based on its interpretation of the Illinois Mortgage Act, 765 ILCS 905/1, *et seq.*, and Illinois Mortgage Certificate of Release Act, 765 ILCS 935/1, were properly rejected by the District Court. Simply put, neither statute provides for the automatic release by way of payment, as the District Court explained. [A.29-30] BC57's argument is contrary to the language of the statutes cited, and contrary to legal authority. Further, BC57 also has not identified any facts establishing that the investor lenders, in fact, received payment for the debt to extinguish their first position mortgage interests. [*See also* Dkt. 1201 at

2] Once again, no statute, caselaw, or argument advanced by BC57 before this Court, or the District Court, changes the outcome of this issue.

BC57 and ILTA suggest that the District Court's ruling that payment did not automatically extinguish the mortgage is both novel and creates havoc for real estate transactions. [Opening Br. at 14-24; Amicus Br. at 4-9] But those are self-serving misstatements. Both the legal and statutory authorities reject such positions. If anything, the arguments advanced by BC57 and ILTA are actually the ones that can create chaos, because such arguments support and protect a lack of diligence by parties in transactions. Put differently, the positions of ILTA and BC57 undermine, not enhance, public policy. Their arguments appear to boil down to a suggestion that a secured interest may be released by payment to anyone, which is not the law. Nor should it be. Allowing payment to an entity without the authority to extinguish the obligations would create the exact chaos and undermine the public policy ILTA claims to defend. The District Court ruled based on a record replete with evidence that *no* effort was taken to understand either the scope of authority of a loan servicer—an entity that was clearly related to, *if not the same as*, the borrower—or problematic payoff statements along with other red flags of

the Cohens' fraudulent scheme (including, *e.g.*, e-mails showing the borrower's manipulation of the payoff letters and releases). In short, based on the record and rulings below, and the discussion above, ILTA's prediction of the death of real estate transactions is manifestly exaggerated.

In sum, there was no abuse of discretion, or legal error regardless of the standard of review, in the District Court's application of the facts and the law based on the record before the Court.

CONCLUSION

For the foregoing reasons, the Receiver respectfully requests that this Court affirm the District Court' s order approving the distribution plan for Group 1. Further, even if the priority decision is overturned in favor of Appellant, all other elements of the distribution plan should be affirmed and the District Court should be instructed to address those additional issues with respect to BC57's loan that were deferred by the District Court.

Dated: August 11, 2023

Kevin B. Duff, Receiver

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Type-Volume Certification

The undersigned counsel hereby certifies that this brief complies with the type-volume limitations of Circuit Rule 32(a), (b), and (c) of this Court, because the brief contains 5,866 words, excluding the parts of the brief exempted by Rule 32(f) of the Federal Rules of Appellate Procedure.

/s/ Michael Rachlis
Michael Rachlis

Certificate of Service

I hereby certify that on August 11, 2023, I electronically-filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Seventh Circuit by using the CM/ECF system. I certify that all participants in this appeal are registered CM/ECF users and that service will be accomplished by and through the CM/ECF system.

/s/ Michael Rachlis
Michael Rachlis