UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

U.S. SECURITIES AND EXCHANGE COMMISSION,	
Plaintiff,	**Civil Action No. 18-CV-5587**
v.	**Judge John Z. Lee**
EQUITYBUILD, INC., *et al.*,	**Magistrate Judge Young B. Kim**
Defendants.	

SEC'S RESPONSE TO INSTITUTIONAL LENDERS' OBJECTIONS

Since February, the Receiver has been attempting to sell properties (a) bought with defrauded investors' money and secured by investors' recorded mortgages, (b) on which institutional lenders later issued new mortgages, even though (c) the investors never were repaid or released their earlier mortgages. (*See,* ECF Nos. 228, 329). At every step in the process, the lenders have objected. Because many of the properties have expenses exceeding revenues, delaying the sales is harming the Receiver, who must continue covering the shortfalls using funds that could otherwise compensate the victims of the Cohens' fraud.

The lenders now claim expedited priority determinations are needed to allow them to credit bid. Yet they failed to raise the issue in multiple earlier objections to the sales process. Moreover, this Court already ruled that priority must be determined through an orderly claims process that provides due process to the investors. And, contrary to the lenders' objections, neither Illinois nor federal law entitles them to credit bid as a matter of right. Further, the fact that one of the largest lenders, Liberty, supports the Receiver's credit bid procedures proves that credit bidding can properly proceed without expedited priority determinations.

Accordingly, the Court should affirm Magistrate Judge Kim's well-reasoned decision allowing the sales process to proceed. Doing so is consistent with the Court's earlier ruling that priority determinations take place in the course of an orderly claims process in order to preserve resources, to allow the Receiver to efficiently administer the receivership per his reasonable business judgment, and to provide the victimized investors due process.

A. Background: The Institutional Lenders Seek to Subordinate the Investors' Earlier Security Interests

As discussed in earlier briefing, the properties the Receiver seeks to sell were originally obtained with money provided by hundreds of the Cohens' defrauded investors. (*See,* ECF No. 114, pp. 4-6; ECF No. 141). In addition to being purchased with investor funds, the investors held security interests on nearly all of these properties. (*Id.*). The mortgages reflecting the investors' security interests were properly filed with the Cook County Recorder of Deeds. (*Id.*). And the investors' mortgages were recorded prior in time to the subsequent mortgages of the institutional lenders. (*Id.*).

The SEC has seen no evidence that the investors were either repaid when the lenders issued their subsequent mortgages, or voluntarily relinquished their security interests. Notably, the lenders do not even allege the investors were repaid or authorized releases of their earlier mortgages. Instead, the lenders now claim that they, "just like" the defrauded investors, were "duped" by Defendants Jerome and Shaun Cohen. (July 2, 2019 Hearing Tr., 5:23-6:1).

For properties where the investors filed their mortgages with the Recorder of Deeds, and where the investors never were paid for or authorized the release of their mortgages, the investors appear to have *prima facie* priority over the later issued mortgages of the institutional lenders. *See, e.g., Fannie May v. Kuipers*, 732 N.E.2d 723, 726, 728 (Ill. App. Ct. 2000) ("A lien that is first in time generally has priority and is entitled to prior satisfaction of the property it

binds … a mortgage lien is created upon the recording of the mortgage with the recorder of deeds … [a] presumption exists that the first mortgage recorded has priority … a perfected mortgage lien remains in effect unless released pursuant to the Mortgage Act") (citations omitted). Thus, the Court should view with skepticism the institutional lenders' claims that Magistrate Judge Kim's procedures infringe on their rights as senior secured creditors.[1]

B. The Court Has Repeatedly Denied the Lenders' Requests for Expedited Priority Determinations

In response to the Receiver's motion to establish the presently ongoing claims process, the institutional lenders filed an objection requesting "immediate" discovery relating to lien priority and an "expedited" determination on whether they or investors held the senior secured interest on the real estate held by the Receiver. (*See*, ECF No. 285, p. 2). The following month, at a hearing before this Court, the lenders again requested an expedited priority determination. (April 23, 2019 Hearing Tr. at 7-13). The Court rejected the lenders' request, holding that priority determinations must take place in the course of an "orderly claims process." (*Id.* at 14).

On May 1, 2019, Magistrate Judge Kim issued an order denying the lenders' request for expedited discovery on priority. (ECF No. 349). The lenders did not appeal.

C. The Lenders Previously Did Not Assert that Priority Determinations Were Necessary in Order to Credit Bid

On May 2, 2019, Magistrate Judge Kim issued an order granting the Receiver's Second Motion to Sell Real Estate, which addressed various properties where investors held earlier-in-

[1] The lenders have argued that, despite the investors having the earlier recorded mortgages, the lenders have higher priority under the "bona fide purchaser" doctrine. (*See, e.g.,* ECF 140, p. 12). However, the Illinois Supreme Court has long held: "Where the prior legal owner is wholly innocent, has neither done nor omitted to do anything, it is inequitable to sustain the claims of a subsequent holder even though he be also a *bona fide* purchaser." *Mitchell v. Sherman E. McEwen Assocs., Inc.*, 196 N.E. 186, 189 (Ill. 1935).

time mortgages. (ECF No. 352). That order authorized credit bid procedures. (*Id.*). Various lenders objected to those credit bid procedures. (ECF Nos. 359, 362, 363). However, none of the objections asserted that priority determinations were required to allow for credit bidding. (*Id.*)

Similarly, in response to the Receiver's Fifth Motion to Sell Real Estate, the lenders again raised objections. (ECF Nos. 365, 368, 370). Again, their objections did not address the lack of *ex ante* priority determinations. (*Id.*). On May 22, Magistrate Judge Kim granted the Receiver's motion, but allowed the lenders additional time to submit proposed credit bid procedures. (ECF No. 382 at 4-5). Liberty then objected to Magistrate Judge Kim's May 22 order, and again raised no objections concerning the absence of priority determinations in the credit bid process. (ECF No. 398).

It was not until June 7, 2019, that the lenders first asserted that priority determinations were necessary to allow them to credit bid. (ECF No. 404 at 5-7).

On June 17, 2019, Liberty advised the Court that, despite its previous objections, it had reached agreement with the Receiver on credit bidding procedures. (ECF No. 415). Those agreed-upon procedures do not contemplate a priority determination in advance of the credit bid process. (*Id.*; ECF Nos. 415-1, 415-2). Likewise, when the other lenders filed their own revisions to the Receiver's credit bid procedures, those revisions did not propose that priority be determined in advance of the bidding. (ECF No. 430, 430-1).

Because the lenders repeatedly failed to object, the Court in the first instance should overrule the lenders' objections, on waiver grounds.

D. There Is No Federal or Illinois Right to Credit Bid

The lenders argue that without an upfront determination of lien priority, their federal and Illinois rights to credit bidding are infringed. But no such rights exist. It is telling that the lenders cite no case holding that credit bidding or expedited priority determinations are required in a federal equity receivership.

The lenders point to the credit bid provisions of the federal bankruptcy code. However, this is not a bankruptcy case, and the code does not apply. While the lenders invoke Local Rule 66.1, which says that the administration of receivership estates shall be "similar" to bankruptcy cases, the lenders provide no authority holding that the Court must or should apply the bankruptcy code in a non-bankruptcy case. On the other hand, Magistrate Judge Kim correctly noted that Local Rule 66.1 gives the Court ample discretion on when to utilize bankruptcy procedures. (ECF 447, p. 7). Magistrate Judge Kim also cited various cases which*, even applying the bankruptcy code*, establish that the Court need not allow credit bidding. (*Id.*, pp. 6-7 (citing *In re Fisker Auto Holdings, Inc.*, 510 B.R. 55 (D. Del. 2014) and *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 315-316 (3d Cir. 2010)).

Regarding the Illinois state law cases cited in the lenders' objection, each of those cases involved credit bidding under statutory *foreclosure* procedures. Because this case involves a federal equity receivership, not a state foreclosure action, the Illinois foreclosure laws do not apply.[2] Indeed, Magistrate Judge Kim noted that the lenders' counsel "confirmed that no Illinois law requires" credit bid procedures along the lines of what the lenders now request. (ECF No.

[2] This Court previously rejected the lenders' request to funnel the subject properties into the state court foreclosure process. (April 23, 2019 Hearing Tr. at 32-40; ECF No. 344).

447, p. 6).[3]

E. The Lenders Can Credit Bid Without a Priority Determination

The lenders claim that they cannot effectively credit bid without an early determination of lien priority. But this contention is disproven by the fact that one of the largest lenders, Liberty, has agreed to credit bid procedures that do not include a priority determination. Consistent with Liberty, the other lenders themselves did not propose priority determinations when they submitted their own revisions to the Receiver's credit bid procedures. (ECF No. 430, 430-1).

Similarly, adopting Magistrate Judge Kim's sales procedures will not materially harm the institutional lenders. The lenders are large financial institutions, with substantial resources that have allowed them to challenge the Receiver at every conceivable opportunity. The lenders appear more than able to either obtain the letters of credit per Magistrate Judge Kim's procedures, or (if they win the bidding) to simply pay cash and receive reimbursement when they later sell the properties. While credit bidding may be an efficient way to proceed in foreclosure cases where lien priority is undisputed, those same efficiencies are not present here where priority is in dispute and the investors have a *prima facie* showing of seniority.

F. Delaying the Sales Process is Harming the Receivership and Investors

Granting the relief sought by the lenders – imposing time- and resources-intensive endeavors such as discovery and priority hearings – will harm the Receivership and mean less funds available for the victims of the Cohens' fraud. This is because the real estate the Receiver has been attempting to sell includes money-losing properties whose operating income does not cover their expenses. (*See, e.g.*, ECF No. 467, at 2-3; July 2, 2019 Hearing Tr. at 17-19, 22).

[3] At the July 2, 2019 hearing, lenders' counsel conceded that no case applying Illinois law mandates the relief the lenders now seek. (July 2, 2019 Hearing Tr. at 11:10-25)

Every additional day that the Receiver is required to maintain the properties he has been trying to sell for months means more expenses such as operating shortfalls, taxes, insurance, water bills, code violation repairs, and legal costs. (*Id.*; ECF No. 467 at 5, 6, 15). For this reason, the Receiver's conclusion to sell the properties without costly *ex ante* priority determinations is a sound exercise of the reasonable business judgment entrusted to him by the Court.

In short, preventing the Receiver from selling negative cash-flowing properties, to wait for a time-consuming priority determination process, forces the Receiver to devote additional moneys to the properties that could otherwise be spent compensating investors and other creditors. Moreover, requiring the Receiver to engage in discovery and priority hearings now would burden him with substantial additional costs, without the benefit of the proceeds of the properties he has been trying to sell since February.

G. Conclusion

The institutional lenders' demands for an expedited priority determination run contrary to this Court's rulings. Allowing the sales process to proceed would not materially prejudice the lenders, especially in light of their repeated failures to raise objections regarding the lack of priority determinations. On the other hand, reversing Magistrate Judge Kim's sales procedures would cause significant harm to the Receiver and investors, by forcing the Receiver to maintain money-losing properties and to devote significant resources that could otherwise benefit the defrauded investors and other creditors. Accordingly, the Court should overrule the lenders' objections and allow the sales process to proceed.

Dated: August 14, 2019

Respectfully submitted,

/s/ Benjamin Hanauer

Benjamin J. Hanauer (hanauerb@sec.gov)
Timothy J. Stockwell (stockwellt@sec.gov)
U.S. Securities and Exchange Commission
175 West Jackson Blvd., Suite 1450
Chicago, IL 60604
Phone: (312) 353-7390
Facsimile: (312) 353-7398

CERTIFICATE OF SERVICE

I hereby certify that I provided service of the foregoing Response, via ECF filing, to all counsel of record and Defendant Shaun Cohen, on August 14, 2019. I further certify that I caused the foregoing Response to be served on Defendant Jerome Cohen, via email at jerryc@reagan.com.

/s/ Benjamin Hanauer

Benjamin J. Hanauer
175 West Jackson Blvd., Suite 1450
Chicago, IL 60604
Phone: (312) 353-7390
Facsimile: (312) 353-7398

One of the Attorneys for Plaintiff