UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

GPB CAPITAL HOLDINGS, LLC; ASCENDANT CAPITAL, LLC; ASCENDANT ALTERNATIVE STRATEGIES, LLC; DAVID GENTILE; JEFFREY SCHNEIDER; and JEFFREY LASH,

Defendants.

21-cv-00583-MKB-VMS

ECF CASE

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION FOR AN ORDER APPOINTING A RECEIVER AND IMPOSING A LITIGATION INJUNCTION

SECURITIES AND EXCHANGE COMMISSION

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June 13, 2022

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Plaintiff Securities and Exchange Commission ("Plaintiff" or the "Commission"), respectfully submits this memorandum of law in support of its motion ("Motion") for an Order (1) appointing the previously appointed independent monitor, Joseph T. Gardemal III, as Receiver, and (2) imposing a litigation injunction. Defendant GPB Capital Holdings LLC ("GPB CH"), by its Chief Executive Officer, has consented to entry of the Proposed Order Appointing Receiver and Imposing Litigation Injunction attached as Exhibit 1 to the Declaration of Neal Jacobson. In addition, the state securities regulators of Alabama, Georgia, Illinois, Massachusetts, Missouri, New Jersey, New York and South Carolina listed in Dkt. 11-5 who have filed administrative and/or civil enforcement actions against GPB CH (the "State Securities Regulators"), have advised the Commission staff that they support entry of the Proposed Order Appointing Receiver and Imposing Litigation Injunction.

I.

PRELIMINARY STATEMENT

Defendant David Gentile ("Gentile"), who is charged with orchestrating the massive fraud at issue in this action and is also awaiting trial in a parallel criminal action[1], recently launched an effort to re-take control of GPB CH and the nearly $1 billion in cash that GPB CH holds. These funds should be returned to the victims of Gentile's fraud, and Gentile's efforts to seize control should be rejected. The Amended Order Appointing Monitor (the "Monitor Order") (Dkt. 39) allows the Commission in these circumstances to make a motion to convert the monitorship to a receivership. Gentile's conduct makes the receivership a necessity.

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[1] *United States v. David Gentile*, 21-cr-00054 (DG)(PK). The criminal indictment and the Commission Complaint, allege, among other things, that Gentile misrepresented that monthly distributions to investors would be made from operations when, in fact, investor capital was used to pay a material portion of the distributions. The Commission Complaint also alleges that Gentile engaged in self-dealing by paying himself millions of dollars in fees that were not disclosed clearly to investors. Motion practice and discovery are proceeding in the criminal action, and no trial has yet been scheduled.

As noted, GPB CH has in excess of $920 million in proceeds from the sale of its most valuable portfolio companies that belong to over 17,000 investors, including approximately 4,000 senior citizens, but has no concrete plan to distribute any of those funds to its owner-investors. Gentile now seeks to take control over GPB CH by exercising purported ownership rights in GPB CH to install his three newly selected managers to GPB CH's board of managers apparently under a bizarre notion that GPB CH and the Monitor were required to continue to follow his investment objectives rather than oversee an orderly liquidation to maximize the value of the portfolio companies and to return the limited remaining investor funds back to the investors.[2] Gentile's actions have caused GPB CH to violate the Monitor Order which authorizes the conversion of the monitorship to a receivership under the Monitor Order.

In addition, although the work of liquidating the portfolio companies owned by the limited partnership investment funds managed by GPB CH (the "GPB Funds") is largely complete, GPB CH and its management subsidiary, Highline Management Inc. ("Highline"), formed shortly before the filing of this case, are continuing to incur approximately $7 million per quarter in management fees and operating services-a substantial portion of which would otherwise go to investors.[3] The Monitor has repeatedly asked GPB CH management for a concrete plan to begin distributing money to investors, to no avail. If the Monitor is converted to

[2] Upon information and belief, one of Gentile's purported appointees, Michael Fasano, was formerly a partner with Gentile's current criminal defense firm, Kobre & Kim, and another purported appointee, Matt Judkin, was enjoined on consent in 2008 in the State of Texas from destroying documents of a foreclosure assistance firm he was associated with, engaging in the foreclosure mitigation business, and engaging in any telephone solicitation of any Texas resident without prior registration and posting of a bond with the Texas Secretary of State in *Texas v. Foreclosure Assistance Solutions, L.C.C., et al.*, 2007-CI-13943 (Tex. Dist. Ct. Bexar County).

[3] Highline was formed by Gentile during the Commission's pre-Complaint investigation, apparently in an effort to insulate GPB CH management, and, as discussed further below, its management role is poorly defined.

a receiver, he will be in a position to quickly streamline operations, propose a summary proceedings claims process and distribution plan, and begin a distribution of funds to the investors in a timely manner under this Court's supervision.

In addition to being necessary to fend off Gentile's takeover ploy, a receivership is necessary because the Commission is not confident that the current management structure, which includes an ambiguous oversight role by the Board of Directors of Highline, is capable of making the decisions necessary to effectuate a timely and cost-effective distribution to investors. Accordingly, the Commission believes that appointment of a receiver is necessary and in the best interest of investors.

II.

PROCEDURAL BACKGROUND[4]

1. Institution of the Action

This action was filed on February 4, 2021. In its complaint, the Commission alleges that Gentile, GPB CH's former chief executive officer who has been charged criminally with securities fraud, perpetrated a $1.7 billion offering fraud that victimized approximately 17,000 investors nationwide.[5] Because Gentile and his hand-picked management team continued to control GPB CH, whose primary assets consisted of portfolio company automobile dealerships, the Commission moved on February 8, 2021, for appointment of an independent monitor to oversee the operations of GPB CH and its affiliates. The Commission sought to ensure that GPB

[4] The facts supporting this motion are based on the Declaration of Joseph T. Gardemal III ("Gardemal Dec."), filed concurrently herewith, and the record in this case.

[5] On February 5, 2021, Gentile resigned as the sole manager of GPB CH and appointed Robert Chmiel as manager and interim CEO of GPB CH. On July 1, 2021, Robert Chmiel's interim CEO designation was removed and he was named CEO. (Gardemal Dec. at ¶ 10) As described more fully below, on May 27, 2022, Gentile attempted to install new managers to GPB CH's board of managers.

CH could maintain its existing agreements with automobile manufacturers and lenders as well as other portfolio company agreements that might have been impaired by Gentile's arrest and the Commission's charges against him, as well as charges brought against him by the State Securities Regulators.

The Commission's motion resulted in the Court's Monitor Order, which GPB CH consented to, which provides, among other things, that the Monitor has the power to approve "any decision to resume distributions to investors in any of the GPB [CH] Funds." (Dkt. 39 at p. 3). Gentile was represented by counsel, was aware that a Monitor would be appointed, and did not object to entry of the Monitor Order. (Gardemal Dec. at ¶ 4)

2. The Monitorship

In the fourteen months since the Monitor was appointed, he has gained first-hand knowledge of the operations of GPB CH, Highline, the GPB Funds, and their related portfolio companies and other investments. (Gardemal Dec. at ¶ 11) Early on in his engagement, the Monitor recommended the continuation of the monitorship for 180 days rather than the filing of any bankruptcy cases or the conversion of the monitorship to a receivership primarily because, in his view, the successful sale of GPB CH's investment in its automotive dealerships, operated as the Prime Automotive Group ("Prime Auto"), was imperative to achieve a maximum return for investors, and a bankruptcy or receivership would have impaired the value of Prime Auto. (Gardemal Dec. at ¶ 13) As a result of the work performed by the Monitor and his team, company management, and supporting professionals, Prime Auto was sold to a buyer for gross consideration of $880 million on November 18, 2021, and the transaction has been substantially completed. (Gardemal Dec. at ¶ 14). In addition, another portfolio company, Alliance Physical

Therapy ("APT") was sold on December 22, 2021, and an approximately 30 acre parcel of land in Newark, NJ (the "Newark Property") was sold in April 2022. (Gardemal Dec. at ¶ 15)

III.

THE NEED FOR A RECEIVER

1. Gentile's Attempt to Take Control over GPB CH

GPB CH is the general partner of each of the GPB Funds, and therefore the board of managers of GPB CH effectively exercises direct control over the GPB Funds. (Gardemal Dec. at ¶¶ 5, 6 & 20) On or about May 27, 2022, Gentile advised GPB CH's current CEO, who is also a manager, that he had appointed three new managers to the GPB CH board of managers, and directed the CEO to cooperate with his newly installed managers to "seek consensus . .. regarding the course of GPB and any actions to be taken by the Managers." (Gardemal Dec. at ¶ 19). In addition, upon their appointment, the new managers and Gentile modified the existing GPB CH operating agreement to benefit Gentile personally, continuing his pattern of self-dealing. The Gentile-modified operating agreement provides, among other things, (i) the new managers including Gentile with expanded access to information rights; (ii) lucrative compensation packages for the new managers including payments of up to $400,000 each per year; (iii) that further amendments to the operating agreement could be made by Gentile unilaterally; (iv) mandatory tax distributions to Gentile; (v) exclusive jurisdiction in Delaware Chancery Court for all actions relating to the operating agreement; and (vi) advancement of expenses. (Gardemal Dec. at ¶ 21)[6]

[6] As set forth in its June 6, 2022 letter to the Court (Dkt. 85), it is the Commission's view that this action is a direct violation of Paragraph 6.d. & e. of the Monitor Order as it resulted in GPB CH's retention of management level persons and their significant compensation without Monitor approval, which is in and of itself a basis for the conversion of the monitorship to a receivership.

Subsequent to making these personnel changes, Gentile filed a motion on May 31, 2022, seeking to amend the Monitor Order pursuant to Fed. R. Civ. P. 60(b) to curtail the Monitor's powers (the "Rule 60(b) Motion"). (Dkt. Nos. 79-83) The thrust of the Rule 60(b) Motion is to argue that the Monitor Order should be amended because the Monitor and current GPB CH management are engaging in a liquidation strategy, rather than continuing to operate GPB CH and the GPB Funds as going concerns with a long term investment outlook, and now that GPB CH's automotive assets have been liquidated the Monitor's role is substantially complete.

Gentile's primary allegations in his Rule 60(b) Motion are at best misleading and are clearly rebutted in detail by the Monitor. (Gardemal Dec. at ¶ 23) For instance, Gentile asserts that current management and the Monitor have "sought to cut [him] off from all information about the company he owns," and "**of which he is the sole owner**." Rule 60(b) Motion at 6 & 14 (emphasis in original). However, GPB CH is merely the general partner of the GPB Funds, whose beneficial owners are the approximately 17,000 investors who were defrauded by Gentile and whom the Commission and the Monitor are seeking to protect in this action. (Gardemal Dec. at ¶ 23.A.)

Gentile also repeatedly argues incorrectly that paragraph 14 of the Monitor Order requires the GPB Funds and the Monitor to follow Mr. Gentile's original investment strategy for the funds. Rule 60(b) Motion at 7, 10, 11 & 19. As the Monitor clearly states, this paragraph merely requires management to provide the Monitor with the information necessary for the Monitor to evaluate the state of the various GPB Funds and to inform his and management's subsequent decision making, and not an instruction by the Court to continue Gentile's original investment strategy. (Gardemal Dec. at ¶ 23.B.) It is nonsensical to believe that the Commission would agree at the outset of this case to require the Monitor to follow the investment strategy of

the very person it had just accused of defrauding investors (and who had just been indicted for the same conduct).

Gentile also accuses the Monitor and management of engaging in a "fire sale" of the GPB Funds' assets. Rule 60(b) Motion at 3 & 7. To date the Monitor approved of the sale of Prime Auto, APT, and the Newark Property at management's request and in a manner designed to maximize shareholder value. (Gardemal Dec. at ¶ 23.D.) Tellingly, Gentile himself admits that Prime Auto was sold for "a significant gain for the majority of investors," (Rule 60(b) Motion at 2), thus providing further evidence that his Rule 60(b) Motion arguments are mere pretexts to gain control over GPB CH.

In the Commission's view, Gentile's distortion of the factual record in an effort to gain control over GPB CH, the GPB Funds, and the $1 billion in cash earmarked for investors, requires that a receiver be appointed to take exclusive managerial control over GPB CH and the GPB Funds under this Court's jurisdiction for the benefit of investors.

2. A Receiver is Necessary to Expedite Distributions to Investors

Since the completion of the sales of Prime Auto and APT last year, GPB CH's primary asset consists of a pool of over $920 million in cash generated from the sales of Prime Auto and APT, in addition to the continued operation of only a small number of remaining portfolio companies. (Gardemal Dec. at ¶¶ 24 & 25) Notwithstanding the availability of significant cash holdings approximating $1 billion, and GPB CH's and Highline's agreement in concept on the need for immediate planning to distribute funds to investors, GPB CH's current management and Highline have been unable to provide any actionable distribution plan or proposal to the Monitor for his approval.

Specifically, the Monitor met with GPB CH management in October and December 2021 and again on February 23, 2022, April 14, 2022, and May 26, 2022, to discuss planning for making distributions to investors. (Gardemal Dec. at ¶ 26) Although management expressed the goal of making distributions, it mostly focused on the challenges that would impede making timely distributions and has not been able to offer any concrete plan or proposal to the Monitor to effectuate an interim or other distribution. (Gardemal Dec. at ¶ 26)

GPB CH Management's inability to move forward with concrete steps to effectuate a distribution to investors is exacerbated by GPB CH's cumbersome corporate governance structure, which, upon information and belief, was put in place by prior management purportedly to provide governance independent of GPB CH's prior management in light of the investigations against it. Specifically, GPB CH is now partly managed by the board of directors of Highline, a subsidiary of GPB CH, whose management function is set forth in a management services agreement between Highline and GPB CH which extends through the end of 2024. (Gardemal Dec. at ¶ 9) The management services agreement focuses mostly on providing GPB CH with management services for the GPB Funds, and does not clearly define the Highline Board's duties and responsibilities. (Gardemal Dec. at ¶ 34)

Now that the GPB Funds' investments have been substantially reduced to cash, there appears to be no constructive continuing role for Highline's Board in this management structure, as it continues to collect significant fees that would otherwise be distributed to investors. At bottom, the Highline Board's ill-defined duties and the circuitous governance framework between it and GPH CH management has resulted in a governance structure ill-suited to making tough and important decisions that may impact the Highline Board members' personal liability, necessary to effectuate a timely distribution to investors.

As set forth in the Gardemal Declaration, if appointed Receiver, Mr. Gardemal is prepared to propose a claims process and a distribution plan within 45 days or less after his appointment, with the goal of distributing as much of the available cash as possible to investors shortly thereafter, with additional distributions to be made upon the resolution of additional claims against GPB CH assets. (Gardemal Dec. at ¶ 28) Such a Court-supervised process effectuated by the Receiver would eliminate duplicative work by GPB CH, the Highline Board and the current Monitor team; would provide due process and a streamlined summary receivership process to resolve claims; and would provide transparency to the more than 17,000 investors waiting for some return of their principal investments. The Commission believes that appointment of a receiver is imperative in this case in order to effectuate a stable and timely distribution process for the approximately 17,000 investors, and to prevent Gentile from attempting to influence the process for his own benefit.

IV.

ARGUMENT

1. A Receiver is Necessary to Establish Clear Corporate Governance with the Goal of Effectuating an Orderly Distribution

A "district court has broad equitable power to fashion appropriate remedies for federal securities law violations." *SEC v. Whittemore*, 659 F.3d 1, 9 (D.C. Cir. 2011) (internal citations omitted). Courts have consistently held that a district court's inherent equitable power to fashion remedies for securities law violations includes the power to appoint a federal equity receiver. *SEC v. Byers*, 609 F.3d 87, 92 (2d Cir. 2010) ("There is no question that district courts may appoint receivers as part of their broad power to remedy violations of federal securities laws."). *See also SEC v. Am. Bd. of Trade, Inc.,* 830 F.2d 431, 436 (2d Cir. 1987); *SEC v. Materia*, 745

F.2d 197, 200 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985). In addition to a court's inherent equitable authority, statutory authority under Exchange Section 21(d)(5) provides: "In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors." 15 U.S.C. §78u(d)(5).

Courts appoint receivers when they are necessary to: (1) preserve the status quo while various transactions are being unraveled in order to determine an accurate picture of the fraudulent conduct, *SEC v. Manor Nursing Ctrs, Inc.*, 458 F.2d at 1082, 1105 (2d Cir. 1972); (2) protect "those who already have been injured by a violator's actions from further despoliation of their property or rights," *Esbitt v. Dutch-Am. Mercantile Corp.,* 335 F.2d 141, 143 (2d Cir. 1964) (internal quotations omitted); (3) prevent the dissipation of the defendant's assets pending further action by the court, *SEC v. Am. Bd. of Trade, Inc.*, 830 F.2d 431, 436 (2d Cir. 1987); or (4) install a responsible officer of the court who could bring the companies into compliance with the law, *id*. at 436-37.

Here, a receiver is necessary for the protection of investors to ensure a clear corporate governance structure, unhampered by Defendant Gentile's improper attempts to assert control and by the cumbersome decision-making process between management and Highline. As set forth in the Commission's June 2, 2022 letter to the Court (Dkt. 85), the installation of new managers and the setting of their lucrative compensation packages without Monitor approval caused GPB CH to violate the Monitor Order, and is in and of itself a basis for the conversion of the monitorship to a receivership.[7]

[7] The Monitor Order provides that the monitorship can be converted to a receivership in the event of material uncured breaches of the Monitor Order. (Dkt. 39, Par. 20-21) Gentile's actions have caused GPB CH to retain three new managers with lucrative compensation packages without Monitor approval, as required by paragraphs 6.d & e. of the Monitor Order. As a result, on May 31, 2022, the Monitor

In the Commission's view, only a receiver, subject to the Court's supervision, can ensure a timely, fair and transparent process for resolving claims against GPB CH and its affiliates and to begin to distribute the substantial cash sitting dormant in GPB CH's accounts to investors, as current management and Highline have been unable to take the steps necessary to effectuate a timely distribution. As part of its inherent equitable and statutory power to fashion relief for investors, a district court may review and approve a receiver's distribution plan if it is "fair and reasonable." *See SEC v. Byers*, 637 F. Supp. 2d 166, 174 (S.D.N.Y. 2009) ("In general, this Court has broad authority to craft remedies for violations of the federal securities laws. Courts have held that within that broad authority lies the power to approve a plan of distribution proposed by a federal receiver. The Court has the authority to approve any plan provided that it is fair and reasonable.") (citations and quotations omitted), *aff'd sub nom*. *SEC v. Malek*, 397 F. App'x 711 (2d Cir. 2010). If appointed Receiver, Mr. Gardemal is prepared to present to the Court for review and approval a plan for resolving claims and making a distribution to investors no later than 45 days after his appointment.

Importantly, a receivership can expedite the claims process and the ability of the receiver to distribute funds to investors by utilizing summary proceedings. *SEC v. Byers*, 637 F. Supp. 2d 166, 184 (S.D.N.Y.) (Chin, J.) ("It is well-settled that a District Court has the authority, in implementing a distribution plan in a receivership case, to use summary proceedings to evaluate claims and claim priority, provided the parties have an opportunity to be heard to argue their claims."); *SEC v. Varacchi*, 2020 U.S. Dist. LEXIS 48034 at *10 (D. Conn., Mar. 20, 2020) ("[T]he traditional rule is that summary proceedings are appropriate and proper to protect equity receivership assets . . . . Summary proceedings can reduce the time necessary to settle disputes,

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served a written notice of material breach to GPB CH and Gentile. (Gardemal Dec. at ¶ 22) Upon information and belief, Gentile has failed to cure these GPB CH's breaches, which he caused.

decrease litigation costs, and prevent further dissipation of receivership assets.") (internal citations omitted).

2. A Litigation Injunction is Appropriate Here[8]

The Commission believes that a litigation injunction is necessary to consolidate all claims against GPB CH and the GPB Funds in order to effectuate an orderly claims and distribution process. "It is axiomatic that a district court has broad authority to issue blanket stays of litigation to preserve the property placed in receivership pursuant to SEC actions." *SEC v. Stanford Int'l Bank Ltd.*, 424 F. App'x 338, 340-41 (5th Cir. 2011) (citing *Schauss v. Metals Depository Corp.*, 757 F.2d 649, 654 (5th Cir. 1985) and *SEC v. Wencke*, 622 F.2d 1363, 1372 (9th Cir. 1980)). *See also Reserve Fund Secs. & Derivative Litig. V. Reserve Mgmt. Co.*, 673 F. Supp. 2d 182, 202-03(S.D.N.Y. 2009) (court entered litigation injunction in connection with implementation of distribution plan recommended by the Commission for a mutual fund subject to the court's jurisdiction, as injunction was necessary to preserve the court's jurisdiction over a "limited res" and was authorized by the All Writs Act and Section 21(d)(5) of the Exchange Act, which allows the court to "grant any equitable relief that may be appropriate or necessary for the benefit of investors.").

Courts may also issue "anti-litigation injunctions barring bankruptcy filings as part of their broad equitable powers in the context of an SEC receivership." *SEC v. Byers*, 609 F.3d 87, 91 (2d Cir. 2010) (joining the Ninth and Sixth Circuits in approving anti-litigation injunctions to preserve receivership assets). In *Byers*, the Second Circuit cited approvingly of the Sixth Circuit decision that upheld a litigation injunction, noting that the "Sixth Circuit concluded, the district court may require all such claims be brought before the receivership court for disposition

[8] The proposed litigation injunction will not affect any criminal or police or regulatory actions by the United States of America or by the states.

pursuant to summary process consistent with the equity purpose of the court."). *Id.* at 91-92 (internal citations omitted). Here, GPB CH and the GPB Funds are facing a number of complicated and uncertain actions by investors and others that threaten to delay distributions to investors. (Gardemal Dec. at ¶ 29) An anti-litigation injunction that enjoins the continuation of pending actions, as well as the filing of any bankruptcy, foreclosure, receivership, or other actions by or against GPB CH and its affiliates, is necessary to centralize all claims to the assets before this Court. The injunction will streamline the claims process to prevent potentially disparate actions in different courts that could affect the receivership assets subject to this Court's jurisdiction and control. Centralizing the actions before this Court and addressing them in a summary process will expedite the ability to begin making distributions to investors.

V.

CONCLUSION

For all of the foregoing reasons, the Commission respectfully requests that the Court grant the Commission's Motion to (i) convert the Monitor to a receiver; (ii) appoint Joseph T. Gardemal III as Receiver; and (iii) enter the litigation injunction.

Dated: New York, NY
June 13, 2022

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