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; JEFFRY SCHNEIDER; and JEFFREY LASH,

Defendants.

21-cv-00583-MKB-VMS

ECF CASE

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

SECURITIES AND EXCHANGE COMMISSION

Alistaire Bambach
Neal Jacobson
David Stoelting
Kristin M. Pauley
Lindsay Moilanen
Attorneys for Plaintiff
Securities and Exchange Commission
New York Regional Office
100 Pearl Street, Suite 20-100
New York, NY 10004-2616
212-336-0095 (Jacobson)

July 8, 2022

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Plaintiff Securities and Exchange Commission ("Plaintiff" or the "Commission"), respectfully submits this reply 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.

I. PRELIMINARY STATEMENT

Gentile resigned as manager of GPB CH on February 5, 2021 and he admits in his opposition brief that he should not be involved in managing GPB CH while his criminal indictment and the legal actions against him are pending, and that GPB CH requires independent oversight. (Dkt. 102 at 2) Nevertheless, he asks the Court to allow him to substitute himself with his nominees to do what he admits he should not be permitted to do himself—manage GPB CH. Far from being an extraordinary remedy, the appointment of a receiver under the circumstances of this case-where Gentile is attempting to appoint new management for GPB CH-was contemplated by the parties in the Monitor Order, which Gentile did not oppose.

That Gentile's actions are designed to benefit Gentile himself is confirmed by his nominees' doing his bidding since their appointment. First, at Gentile's direction they purported to amend the GPB CH operating agreement to permit Gentile to make any further amendments unilaterally (the original operating agreement required the approval of the managers), to provide mandatory tax distributions to Gentile, to advance expenses, and to pay themselves up to $400,000 per year without consulting with, or seeking the vote of, the sole existing manager, Robert Chmiel, who has been on the ground as manager and CEO of GPB CH since February 2021. (Gardemal Dec., Dkt. 90, at ¶¶ 18-21) In addition, they have attempted to interfere with GPB CH management, contrary to the interests of investors, by demanding reinstatement of unnecessary employees terminated in a reduction of force by GPB CH who have combined

annual salaries of approximately $1.7 million. (Supplemental Declaration of Joseph T. Gardemal III, dated July 7, 2022 at ¶ 14)

Gentile's actions belie his professed motivation to maximize returns to investors, and he evenly brazenly states that investors should only receive "reasonable and proper distributions," without any acknowledgement that all of GPB CH's and the GPB Funds assets belong to the investors. (Gentile Opp. at 2) Aside from defendant Jeffry Schneider (also a defendant in the criminal case), the only person opposing the appointment of a receiver is Gentile.[1] Investors want their money back (Gardemal Dec., at ¶ 23.A.), and none have appeared to support Gentile's attempt to regain control over GPB CH.

Moreover, contrary to Gentile's horrible imaginings, the Monitor and GPB CH have been, and continue to be, focused on maximizing the value of GPB CH's assets for the benefit of investors. Gentile now complains that the Monitor and GPB CH liquidated the Prime Auto business prematurely (Gentile Opp. at 9-10), although in his Rule 60(b) Motion he lauded the sale as "a significant gain for the majority of investors." (Dkt. 80 at 2). In any event, as the Monitor makes clear, due to the criminal and Commission proceedings against Gentile and the lack of GPB Funds' audited financial statements, automobile manufacturer counterparties to Prime Auto began the process of terminating their contractual relationships with Prime Auto, which would have resulted in a "near complete destruction of going concern value for Prime Auto's underlying business." (Supp. Gardemal Dec. at ¶ 3)

The Monitor also makes clear that GPB CH and the Monitor have been focusing and they continue to focus on engaging in careful and thorough evaluation of all available approaches and

[1] Defendant Jeffry Schneider opposes the appointment of a receiver on grounds related to the attorney-client privilege and the advancement of legal fees and expenses.

strategies to maximize the value to investors, whether by continuing to hold an asset, seeking to otherwise unlock value through a strategic transaction, or by divestiture. (Supp. Gardemal Dec. at ¶ 6)

In the Commission's view, the Court should put an end to Gentile's charade and appoint a capable receiver who will have a fiduciary duty to maximize returns to investors in a prudent and transparent manner subject to the Court's oversight.

II. ARGUMENT

A. Violation of the Monitor Order Justifies the Appointment of a Receiver for the Benefit of Investors Pursuant to its Terms.

Gentile contends that the "SEC specifically chose not to apply to the Court for a receivership at the outset of this case," hypothesizing that either the Commission could not have met the burden for appointment of a receiver or that it was not necessary. (Gentile Opp. at 3-4)

As discussed further below, although the Commission had ample evidence to seek the appointment of a receiver at the outset of this case, it chose not to do so for two reasons. First, the Commission staff was advised during its investigation and before the filing its Complaint that appointment of a receiver could severely diminish the value of the Prime Auto business, which comprised most of GPB CH's value, to the detriment of investors. This is also one of the reasons the Monitor did not initially recommend conversion of the monitorship to a receivership. (Gardemal Dec. at ¶ 13) Second, on February 5, 2021, and prior to the Commission's motion for appointment of a monitor, Gentile voluntarily resigned as manager of GPB CH, so that a receiver was not necessary to oust him from control over GPB CH for the protection of his approximately 17,000 defrauded investors.

In order to ensure that Gentile would be unable to exert any direct or indirect control over GPB CH, among other reasons, the Commission sought the appointment of a Monitor. The

Monitor Order itself contemplates the appointment of a receiver if deemed necessary, first by providing that a receiver may be appointed if the Monitor Order has been breached by, among other things, appointment of any management-level professional or person, or any material change to compensation of any executive officer, affiliate, or related party without Monitor approval. These provisions were intended in part to ensure that Gentile would be unable to reassert control over GPB CH or the GPB Funds unless the Monitor consented to the appointment of new management. As stated in the Commission's Motion, Gentile has caused GPB CH's direct violation of those provisions by appointing his nominees to control GPB CH. For this reason alone, the Court should appoint a receiver.

Second, paragraph 24 of the Monitor Order required the Monitor to report to the Court within 60 days whether he would recommend converting the monitorship into a receivership, and paragraph 25 permits the Monitor to recommend to the Court the contraction, expansion, continuation or discontinuation of the Monitorship. Here, the Monitor did not initially recommend the appointment of a receiver because of the deleterious effect it would have had on the Prime Auto business. (Gardemal Dec. at ¶ 13) Although the Monitor Order set a 60-day period for the Monitor's report to be filed that could be extended for good cause shown, at the time of the Monitor's report, Gentile had no role in managing GPB CH and GPB CH still owned the Prime Auto business. (Gardemal Dec. at ¶¶ 12-13) The Monitor believes that changed circumstances now require the appointment of a receiver for the benefit of investors. (Gardemal Dec. at ¶¶ 18-38) The fact that the Monitor Order itself, which Gentile was aware of and did not oppose, contains provisions that contemplate the conversion of the monitorship to a receivership confirms that the appointment of a receiver under the particular circumstances of this case is not an extraordinary remedy.

In his Rule 60(b) Motion and in his opposition to the Commission's Motion, Gentile repeatedly asserts that the GPB CH operating agreement permitted him to appoint his nominees as managers. Whether or not the GPB CH operating agreement permitted Gentile to make those appointments, however, is irrelevant to the fact that his actions resulted in a direct and knowing violation of the Monitor Order. The Monitor Order is clear that the Monitor has the authority to approve or disapprove of certain actions, and it does not provide any exception for actions taken by the sole shareholder of GPB CH through its operating agreement that bind GPB CH.

By committing GPB CH to retain three new managers for GPB CH who would have control over GPB CH and providing them compensation of up to $400,000 each without Monitor consent, Gentile has knowingly caused GPB CH to be in violation of the Monitor Order, pure and simple. Under the explicit terms of the Monitor Order, this violation is grounds for conversion of the monitorship to a receivership, which has been consented to by GPB CH.

In addition, Section 21(d)(5) of the Securities Exchange Act of 1934 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). In the Commission's view, the status of this case, Gentile's attempt to assert managerial control resulting in a serious uncured breach of the Monitor Order, and Gentile's nominees' recent actions to interfere with GPB CH management to the detriment of investors requires the appointment of a receiver for the benefit of the investors.[2]

[2] A court order appointing a receiver is reviewed only for abuse of discretion. *SEC v. American Bd. of Trade, Inc.*, 830 F.2d 431, 436 (2d Cir. 1987).

B. The Commission Can Show a Likelihood of Success on the Merits.

Although in the Commission's view the provisions of the consented to Monitor Order and Section 21(d)(5) of the Exchange Act obviate the need for the Court to engage in the traditional preliminary injunction analysis for appointment of a receiver for the benefit of investors, Gentile contends that the Commission must still engage in that analysis which requires the Court to ignore that the consented to Monitor Order is in place. Even if the Court were to agree that Gentile's knowingly causing the violation of the Monitor Order that on its face provides for appointment of a receiver is insufficient, the Commission has ample evidence to support appointment of a receiver under the traditional analysis. The Commission's burden of proof for appointment of a receiver under the traditional analysis is the preponderance of the evidence standard. *SEC v. First Fin. Grp.*, 645 F.2d 429, 434 (5th Cir. 1981).

Gentile cites to *SEC v. Amerindo Inv. Advisors, Inc.*, 2013 U.S. Dist. LEXIS 49805 at *45 (S.D.N.Y., Mar. 11, 2013) (Gentle Opp. at 16) for the following general factors supporting the appointment of a receiver:

> [F]raudulent conduct on the part of defendant; the imminent danger of the property being . . . diminished in value or squandered; the inadequacy of the available legal remedies; the probability that harm to plaintiff by denial of the appointment would be greater than the injury to the parties opposing appointment; and, in more general terms, plaintiff's probably success in the action and the possibility of irreparable injury to his interests in the property.

Factor 1: Gentile's fraudulent conduct:

The Commission alleged in its Complaint (and the DOJ in its indictment), that GPB CH made distributions to investors using other investor money rather than making distributions solely from the operations of the GPB Funds' portfolio companies, contrary to its representations to investors.

In his sworn testimony under oath before the Commission in February 2020, Gentile admitted that he knew that investor money, and not only money from the portfolio companies' operations, was being used to pay distributions to investors. An excerpt from Gentile's testimony is attached as Exhibit A to the Supplemental Declaration of Neal Jacobson filed concurrently herewith. In his testimony, Gentile first attempted to minimize the use of investor funds to pay the contemplated 8% distribution by stating that it was "temporary," and that over the "life cycle of the investment" the portfolio companies' operations would generate sufficient income so that the 8% distribution to investors would be paid from operations. Ultimately, however, Gentile admitted that he knew by 2016 that making distributions to investors with money raised from other investors was not merely a temporary mismatch between the timing of the distributions and the ability to extract funds from the portfolio companies' operations. (Jacobson Supplemental Dec., Ex. 1 at pp. 243-245).

Factor 2: Imminent Danger of the value of the property being diminished in value or squandered:

Gentile's attempts to reassert control over GPB CH by purporting to appoint new managers and guaranteeing them up to $400,000 per year in compensation has already resulted in GPB CH and the Monitor incurring substantial legal expenses in addition to the expense that would be incurred for new manager compensation. The purported new managers have already attempted to reverse a reduction in force implemented by GPB CH with Monitor consent to reduce unnecessary expense, thereby confirming that the new managers cannot be trusted to safeguard investor money. If a receiver is appointed, the streamlined management structure will help to reduce the current $7 million quarterly expense related to management and operating service fees charged by GPB CH and Highline to the GPB Funds. Continuing the current management structure, with the added layer of Gentile's nominees, will only increase the costs to

investors and diminish their returns. Moreover, as the Monitor has stated, he and GPB CH have been working and continue to work with competent investment professionals to maximize the value of GPB CH's assets. (Supp. Gardemal Dec. at ¶¶ 5-9)

Factor 3: Inadequacy of available legal remedies:

The current monitorship itself is a creature of equity, so the availability of legal remedies is clearly inadequate. In addition, a receivership at this juncture is far superior to the monitorship as it will reduce costs; consolidate all claims against the receivership entities in one court and allow for their disposition in summary process; and streamline the ability to get money back to the investors in an efficient, transparent, and expedited manner.

Factor 4: Weighing of harms:

Failure to appoint a receiver will result in a continuing diminution of investor assets through the payment of unnecessary management fees and delay resolution of claims against the receivership assets and the ability to make timely distributions to investors. Failure to appoint a receiver will also undoubtedly result in Gentile continuing to interfere with GPB CH management for his own benefit to the detriment of investors. If Mr. Gardemal is appointed receiver, he will act in the best interests of investors and seek to maximize the value of the investors' assets in an appropriate and considered manner.

The only harm to Gentile will be his personal inability to control GPB CH and the GPB Funds through his nominees. Gentile had already relinquished control over GPB CH voluntarily in February 2021, and he acknowledges that it would be inappropriate for him to be involved in the day-to-day management of GPB CH given that he is under criminal indictment. Thus, he has already ceded control over GPB CH. Gentile's claim that only he or his nominees can maximize value for investors is dubious if not outright frivolous. However, if Gentile and his nominees are

serious that they want to maximize investor returns, the receiver, if appointed, can take their views into account when managing the few remaining GPB CH assets.

Factor 5: Likelihood of success on the merits:

As discussed above, Gentile has admitted in sworn testimony that he knew that the use of investor money to make distributions to investors was not merely a temporary glitch in his "life cycle of the investment" business model for providing the returns promised to investors from the operations of the GPB Funds' operations. This is *prima facie* evidence of a violation of the anti-fraud provisions of the federal securities laws. *See, e.g., SEC v. Whitworth Energy Resources, Ltd.*, 2000 U.S. App. LEXIS 31237 at **6-7 (9th Cir. Dec. 1, 2000) ("The source of payment for distributions was material . . . because a reasonable investor would have found it important in making an investment decision.").

As set forth above, the Commission believes that it has met the burden of proof necessary for appointment of a receiver, both under the terms of the Monitor Order and in accordance with the traditional analysis for appointment of a receiver

C. Defendant Jeffry Schneider's Opposition is Premature.

Defendant Jeffry Schneider opposes the appointment of a receiver primarily on the grounds that he believes that the receiver should not inherit the receivership entities' attorney-client privilege because he owns a joint-interest with GPB CH, and that the proposed order might limit his right to advancement of legal fees which he claims he is entitled to by virtue of a ruling by the Delaware Chancery Court. Mr. Schneider's opposition is premature.

If the Court appoints a receiver, the receiver will replace existing management and control the receivership entities' attorney-client privilege. *United States v. Plache*, 913 F.2d 1375, 1381 (9th Cir. 1990) ("Because the privilege was held by the corporation, any right to

assert the attorney-client privilege on behalf of the corporation passed when the receiver . . . was appointed by the court."), *citing, CFTC v. Weintraub*, 471 U.S. 343, 349 (1985). While Mr. Schneider may have some claim to a joint interest privilege with GPB CH that might limit the receiver's ability to waive the receivership entities' attorney-client privilege, that is no different than the current situation where GPB CH management controls the attorney-client privilege. If and when the receiver, if appointed, seeks to waive the receivership entities' attorney-client privilege, the Court can address the applicability of any joint-interest privilege Mr. Schneider or any other defendant may have at that time.

In addition, the Commission has no involvement with and takes no position on GPB CH's and the GPB Funds' obligations, if any, to advance Mr. Schneider's or any other defendant's legal fees and expenses, or the advancement of any other fees and expenses that any parties may seek from the receivership assets. If the receiver determines that the advancement of fees and expenses is mandated by law, and necessary and/or appropriate, the receiver can seek to amend the order to make those payments if they exceed the dollar limits set forth in the order. If the receiver determines that the advancement of fees is not mandated by law, and unnecessary and/or inappropriate, the party seeking such fees and expenses may petition the Court to seek payment of those fees and expenses.

III. 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; (iii) enter the litigation injunction; and (iv) grant such other relief as is just.

Dated: New York, NY
July 8, 2022

Respectfully submitted,
/s/Neal Jacobson
Neal Jacobson
Alistaire Bambach
David Stoelting
Kristin M. Pauley
Lindsay Moilanen
Attorneys for Plaintiff
Securities and Exchange Commission
New York Regional Office
100 Pearl Street, Suite 20-100
New York, NY 10004-2616
212-336-0095