

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
:
SECURITIES AND EXCHANGE COMMISSION :
:
 Plaintiff, :
:
 against, :
:
BEACON HILL ASSET MANAGEMENT LLC, :
A Delaware limited liability company, :
:
 Defendant, :
:
 and, :
:
BEACON HILL MASTER, LTD., et al., :
:
 Relief Defendants. :
:
-----X

02 Civ. 8855 (LAK) (HP)

**JOINT OFFICIAL LIQUIDATORS' REPLY SUBMISSION IN
RESPONSE TO THE SEC'S PARTIAL OPPOSITION TO THE
SETTLEMENT**

The Joint Official Liquidators of Relief Defendant Beacon Hill Master, Ltd. (In Official Liquidation) (the "Master Fund"), Phillip S. Stenger and Theo Bullmore (the "JOLs"), by and through their attorneys, Stenger & Stenger, P.C., offer the following reply submission in further support of the agreed-upon allocation of the proceeds arising from the Global Settlement Agreement ("Settlement Agreement") and in response to the *Partial Objection of Plaintiff Securities and Exchange Commission to the Motion and Brief Seeking Ratification of Global Settlement Agreement and Instructions Regarding Allocation of Settlement Funds* (the "Partial Opposition").

PRELIMINARY STATEMENT

As the Court will recall, the JOLs filed a state court action against several defendants, including BHAM and its principals. Investors representing approximately 43% of invested capital (the “Investor Plaintiffs”) also sued BHAM and Asset Alliance Corporation, among others, in a separate action pending before this Court (the “Investor Action”). Separately, Asset Alliance and BHAM each made claims against the other in an arbitration proceeding.

In late 2005, the Investor Plaintiffs, BHAM and Asset Alliance began settlement discussions as part of a Court ordered mediation before Magistrate Judge Pitman in the Investor Action. As the mediation process unfolded, it became clear that for a settlement to be reached in the Investor Action, the Master Fund needed to be part of the discussions so that a global settlement could be reached. Although the mediation did not lead to a settlement, it did put into motion negotiations which ultimately led to a global settlement between Asset Alliance, BHAM, the Investor Plaintiffs and the Master Fund.

Under the settlement, Asset Alliance agreed to pay \$2,500,000 immediately and \$2,000,000 in 12 months while BHAM agreed to assign a payment stream valued at a minimum of \$1,750,000 million and to waive advancement and indemnification claims against the Master Fund with a current liquidated value of approximately \$6,000,000¹ (the waiver of the indemnification claims only directly benefits the Master Fund). As a result, the total cash value

¹ If the Investor Action had not settled, BHAM had submitted an indemnification claim in the Cayman Islands liquidation for the entire value of any amounts it might have paid out to investors, including Investor Plaintiffs in the Investor Action, which BHAM estimated to be as much as \$1,109,000,000.

of the settlement is \$12,250,000.² BHAM has also agreed, as part of the settlement, to cooperate with the JOLs and Investor Plaintiffs in connection with claims pending against other parties.

The JOLs and the Investor Plaintiffs agreed to split the cash payments equally except that the Investor Plaintiffs would receive \$250,000 more than it would obtain in an even split out of the first \$2,500,000 payment from Asset Alliance³. Thus, the allocation of the cash portion of the settlement is \$3,375,000 to the Investor Plaintiffs and \$2,875,000 to Master Fund. As a result, the total value of the settlement to the Investor Plaintiffs is \$3,375,000 and the total value of the settlement to the Master Fund is \$8,875,000, before accounting for non-monetary consideration.

The JOLs entered into and agreed to the terms of the Settlement Agreement only after lengthy and due consideration was given to each term, as well as applying a balanced analysis of the benefits the Master Fund would receive from it. Throughout the negotiation process, including allocation of the settlement proceeds, both individual investors and the Liquidation Committee, a body of investors nominated to represent the voice of all investors, were consulted and agreed to the decisions made by the JOLs with respect to the Settlement Agreement. Accordingly, the JOLs believe that the terms presented to the Court for ratification, including the suggested allocation of the proceeds, are fair and reasonable and of great benefit to the Master Fund.

In its Partial Opposition to the Motion, the SEC does not object to the settlement itself. Rather, the SEC's objection focuses on the allocation of the settlement proceeds between the

² In the JOLs' Motion to approve the Settlement Agreement, paragraph 8.a., the JOLs mistakenly indicate that the value of the settlement is \$13,000,000.

³ An equal split of \$2,500,000 would have been \$1,250,000 each, so in order to give the Investors Plaintiffs \$250,000 more than the Master Fund, they would receive \$1,500,000, which is what was agreed.

Master Fund and the Investor Plaintiffs and accuses the JOLs of using the allocation of the settlement as an “inappropriate” [Partial Opposition p. 2,3,4,5 and 7] way to secure payment of \$500,000 of the Investor Plaintiffs’ legal fees “through the back door”. [Partial Opposition p. 3] The SEC also objects to the allocation of the settlement because it does not account for approximately \$1.7 million that the Master Fund must pay as part of contractual indemnification claims for fees incurred by ATC and Ernst & Young Cayman Islands as a result of the Investor Action. Finally, the SEC objects to the allocation of the \$30,000 BNL reserve.

DISCUSSION

I. The Allocation of the Settlement Proceeds is Fair and Reasonable.

The JOLs unequivocally deny that the agreed upon allocation of the Asset Alliance payments was made with the intention of reimbursing the Investor Plaintiffs \$500,000- which request Magistrate Judge Pitman recently recommended that the Court deny. The JOLs were not trying to “back door” the Court and the JOLs do not have a “preoccupation” with getting Investor Plaintiffs’ fees paid.

The primary impetus for allocating the additional \$250,000 to the Investor Group is that Asset Alliance is funding the cash payments and the Master Fund has not sued Asset Alliance or threatened any claims against Asset Alliance.⁴ It is not the case, as the SEC asserts, that “Asset Alliance faced potential responsibility for damages against BHAM which the Master Fund had sued.”⁵ [Partial Opposition p. 5] As the Court is well aware, the JOLs have not shied away from

⁴ Since it appeared, even prior to the recent decision issued by Magistrate Judge Pitman, that the Court was not receptive to the request for the \$500,000 reimbursement to the Investor Plaintiffs, the Investor Plaintiffs’ agreement to drop this request was not a significant consideration in the allocation negotiations.

⁵ Before now, the SEC has never suggested to the JOLs that the Master Fund had any claim against Asset Alliance.

instituting litigation which is warranted under the facts and circumstances but did not do so here because there are not sufficient facts to support a claim to pierce BHAM's corporate veil to reach Asset Alliance. The Investor Plaintiffs were able to pursue control person claims against Asset Alliance under the federal securities laws because they had securities claims against BHAM. The Master Fund simply did not have similar claims.

Moreover, it does not "prove too much" to say that Asset Alliance is funding a large portion of the settlement. [Partial Opposition p. 5] How Asset Alliance's \$4,500,000 was divided between the Investor Plaintiffs and the Master Fund was entirely between the Investor Group and the Master Fund- neither Asset Alliance nor BHAM were part of that negotiation. Ultimately, only Asset Alliance knows what its business reasons were to pay \$4,500,000 to settle the Investor Action. However, we do know that as far back as 2005, it was obvious that nothing short of a global settlement would resolve these cases. We also know that the Master Fund and Investor Actions were settled only after BHAM and Asset Alliance had resolved their arbitration proceeding. Dollars are fungible and as long as all claims against it were resolved, Asset Alliance simply did not care who actually received the money it was contributing to the global settlement. And, from the stand point of the Master Fund, the JOLs would not have agreed to the settlement unless the Master Fund received significant dollars.

The JOLs were also motivated to agree to the proposed split because BHAM is abandoning its indemnification and advancement claim against the Master Fund, which currently totals approximately \$6 million and which is of no direct benefit to the Investor Plaintiffs. As the JOLs have previously reported to the Court, Chief Justice Smellie of the Cayman Islands Grand Court has upheld the indemnification claims for costs and fees against the Master Fund by Ernst & Young Cayman Islands. As a result, there was a risk that the Cayman court would uphold

BHAM's indemnification claims, as well. Additionally, a recent opinion issued by Justice Ramos in *Bullmore v. Beacon Hill Asset Management, LLC, et al.*, Index No. 104314/05, suggested that BHAM's indemnification and advancement claims may be appropriate.

Recognizing the likelihood that this potential liability would be realized, the JOLs believed the settlement allocation was clearly beneficial to the Master Fund in large part because of BHAM's abandonment of its substantial indemnification claims.

As a result, it appeared that the Master Fund would have been required to advance litigation costs to BHAM. Of the \$6,000,000 indemnification claim of BHAM, \$5,000,000 were litigation costs (a significant portion of which were incurred in BHAM's defense of the SEC action).

In summary, the JOLs believe that this settlement and the allocation are in the best interest of the Master Fund and fair and reasonable for several reasons:

1]. Asset Alliance, against whom the Master Fund does not have a claim, is providing all of the immediate cash for the settlement (\$2,500,000) and 72% of the total cash for the settlement (\$4,500,000/\$6,250,000).

2]. BHAM has agreed to withdraw its \$6,000,000 indemnification and advancement claims against the Master Fund.

3]. The total value of the settlement is \$12,250,000, of which \$8,875,000 (72%) accrues to the benefit of the Master Fund and \$3,375,000 (28%) accrues to the benefit of the Investor Plaintiffs.

II. The Allocation of Settlement Proceeds is Fairly Balanced Between the Master Fund and Investor Group and any Indemnification Claims Triggered by the Investor Group are Irrelevant to the Settlement Agreement.

The SEC also objects to the allocation “due to the failure of the JOLs to take into account the indemnification damages in the amount of approximately \$1.7 million caused by the Berman investors claims against ATC and Ernst & Young Cayman Islands (“EYCI”). Incredibly, nothing is said to the Court by the JOLs about the indemnification damages caused by the Berman investor’s failed claims.” (footnote omitted) [Partial Opposition, p. 6]⁶

What the SEC fails to tell the Court is that under Cayman Islands law there is no mechanism to amend or withhold distributions to a shareholder as compensation for losses caused to the fund by their actions or inactions.⁷ To charge the Investor Plaintiffs \$1.7 million through the allocation of the settlement as the SEC suggests would be to do indirectly what cannot be done directly. The JOLs believe this attempt to backdoor the laws of the Cayman Islands would be inappropriate.

⁶ The \$1.7 million in indemnification claims currently sought in relation to litigation filed by the Investor Group arise out of pre-existing contracts entered into and executed by the Master Fund, on one hand, and ATC and Ernst & Young Cayman Islands, on the other hand. The JOLs recognize and acknowledge that any obligation under these contracts – to the extent established by ATC or Ernst & Young Cayman Islands – are liabilities of the Master Fund.

⁷ It is also not likely that the corporate laws of the US would provide a mechanism to amend or withhold distributions to a shareholder as compensation for losses caused to the fund by their actions or inactions.

III. The Master Fund's agreement to bear the \$30,000 BNL Escrow Payment is Fair and Reasonable.

Finally, the SEC asserts that the \$30,000 escrow payment established in relation to BNL's claims should be allocated solely by the Investor Group because BNL was formerly a member of that group.⁸ Consistent with their demand that the settlement be global, BHAM and Asset Alliance wanted to include the possible claim of BNL in the settlement. Despite significant efforts by the JOLs to convince BNL to participate in the settlement, BNL simply refused. As a result, for several months after all other items of the settlement were worked out, BNL remained the sole remaining issue.

In the meantime, under the Settlement Agreement, as soon as the Agreement was signed, all CBO Cash Flows would be escrowed pending approval of the Settlement Agreement by this Court and eventually paid 50/50 to the Master Fund and the Investor Plaintiffs after such approval. [Settlement Agreement, paragraph (1)(c), p. 9] Because the Settlement Agreement was not signed in September, the Master Fund and the Investor Plaintiffs were not able to capture the CBO Cash Flow payment made in September of 2006. To avoid that result for the next scheduled payment which occurred in December of 2006, and which was approximately \$87,000, the JOLs made a business decision to agree that the \$30,000 BNL escrow should be allocated to the Master Fund. By agreeing to the BNL allocation and thus capturing the December payment, the JOLs have more than made up for the \$30,000 BNL allocation (if in fact BNL makes a claim).

⁸ The \$30,000 BNL escrow payment only gets paid to reimburse BHAM or Asset Alliance for costs they incur to defend or settle an action which BNL may or may not bring in the future. If BNL takes no further action, then the \$30,000 BNL escrow never gets paid out and the SEC's objection is moot.

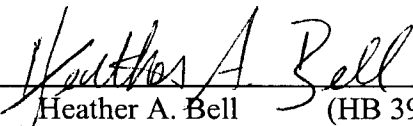
CONCLUSION

For the reasons stated above and based on the many benefits provided to the Master Fund, the JOLs respectfully request that this Court approve the Settlement Agreement and allocation of settlement proceeds already agreed upon by the parties.

Dated: January 9, 2007

Respectfully submitted,

STENGER & STENGER, P.C.

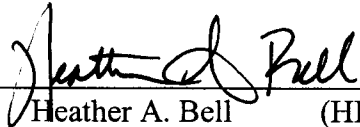
By: 
Heather A. Bell (HB 3960)
Sara E.D. Fazio (SF 4120)
4095 Embassy Dr. SE, Suite A
Grand Rapids, Michigan 49546
(616) 940-1190
(616) 940-1192 (facsimile)

Attorneys for the Joint Official Liquidators

Dated: January 9, 2007.

Respectfully submitted,

STENGER & STENGER, P.C.

By: 
Heather A. Bell (HB 3960)
Sara E.D. Fazio (SF 4120)
4095 Embassy Dr. SE, Suite A
Grand Rapids, Michigan 49546
(616) 940-1190

Attorneys for the Joint Official Liquidators

EXHIBIT A

Theo Bullmore
KPMG
Century Yard
P.O. Box 493 GT
Grand Cayman
Cayman Islands

David Kagan-Kans, Esq.
Kevin O'Rourke, Esq.
U.S. Securities and Exchange Commission
100 F Street, NW
Washington, DC 20549-9612

Seth M. Schwartz, Esq.
Skadden, Arps, Slate, Meagher & Flom
4 Times Square
New York, NY 10036