

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA,)
) No. 06 CR 964
 v.)
) Judge Ronald Guzman
MICHAEL E. KELLY)

**GOVERNMENT’S RESPONSE TO IP FUND’S MOTION
FOR APPOINTMENT OF SPECIAL MASTER**

The United States by Patrick J. Fitzgerald, United States Attorney for the Northern District of Illinois, requests that this Court deny IP Fund 1 Inc. (“IP Fund”) and Thomas B. Ramey Jr.’s motion (hereafter “IP Fund Motion”). In support of this request, the government states as follows:

1. As an initial matter, the specific relief requested in the IP Fund Motion – the appointment of a special master – is redundant to the agreed motions already filed by the government in this case.¹ *See* Docket Nos 78, 82.

2. To the extent that the IP Fund Motion is construed as a request that the Court appoint Resorts Management Group, LLC, (“RMG”) to the position of special master, the government believes that RMG should not be appointed for several reasons: (a) IP Fund and RMG are closely tied to Ernest Bustos, a broker who profited from the sale of Universal Leases to investors, and therefore would have a significant conflict of interest if chosen to serve as special master; and (b) the managers of RMG are less qualified than the eight candidates who previously submitted written proposals to the Court.

¹ While the victim of a crime has the right to be reasonably heard in certain circumstances, *see* 18 U.S.C. § 3771(a), one of the movants here – IP Fund 1 Inc. – is not a victim or the legal representative of a victim and therefore lacks standing to move the court for the requested relief.

The Charged Scheme

3. The information in this case alleges that beginning in or about 1999, defendant Michael E. Kelly fraudulently obtained over \$450,000,000 through the offer and sale of so-called “universal leases” and nine-month promissory notes to thousands of investors located throughout the United States. Defendant sold the universal leases to investors through a network of brokers to whom the defendant paid exorbitant commissions of as much as 18% of the total investment, plus an additional commission to brokers whose clients extended their investments beyond an initial 2-year period. Under the terms of the universal lease, defendant (under the guise of a purportedly independent third party management company) was obligated to pay up to 11% interest to universal leaseholders per annum. In or about late 2005, defendant stopped paying any monies owed to universal lease investors, and to date at least \$330 million of the funds fraudulently obtained from investors is still owed to defrauded investors.

Conflict of Interest Relating to Ernest Bustos

4. From approximately 2001 through 2004, Ernest Bustos sold universal leases to investors on behalf of defendant Michael E. Kelly.² During that time, he received at least \$158,000 in commissions derived from the sale of those universal leases. (SEC Memo (Att. A), at 5). As a

² See Intervenor Securities and Exchange Commission’s Memorandum in Opposition to Plaintiffs’ Application for Appointment of a Temporary Receiver, *IP Fund 1, Inc., et al v. Michael E. Kelly, et al.*, No. 307 CV 1556-P (ND Tex.) (Solis, J.) (hereafter “SEC Memo”) (appended hereto as Attachment A), at 5. The Declaration of Kevin Barrett, submitted in support of the SEC’s memorandum, is appended hereto as Attachment B (hereafter “Barrett Dec.”). The exhibits to the Barrett Declaration, consisting of 186 pages, have been omitted to conserve space, but will be provided to the Court if requested.

IP Fund’s Response to Intervenor SEC’s Opposition to Plaintiff’s Application for Appointment of a Temporary Receiver is appended hereto as Attachment C (hereafter “IP Fund Response”). The Declaration of Ernest Bustos, submitted by IP Fund in support of its response to the SEC’s memorandum, is appended hereto as Attachment D. The exhibits to the Bustos Declaration, consisting of 174 pages, have been omitted to conserve space, but will be provided to the Court if requested.

broker who profited from the sale of universal leases, Bustos could be subject to an action brought by the special master seeking the disgorgement of any improperly obtained monies. In fact, the SEC has already filed a civil lawsuit naming as defendants many of the brokers who collected in excess of \$1 million in commissions through the sale of universal leases. *See United States Securities and Exchange Commission v. Michael E. Kelly, et al.*, 07 C 4979 (N.D. Ill) (Bucklo, J.).³

5. On February 10, 2006, after defendant Kelly stopped making any payments to universal leaseholders, Bustos created IP Fund. (Barrett Dec. (Att. B), at ¶ 12). IP Fund purports to be a corporation organized under the laws of the State of Texas whose “members” purchased Universal Leases from defendant Kelly through Mark G. Meyer and “others.” (IP Fund Motion, at Ex. A, ¶ 1). Bustos serves as IP Fund’s registered agent and sole director. (*See* Westlaw Corporate Records & Business Registrations, TX800612272, appended hereto as Attachment E).

6. After creating IP Fund, Bustos solicited “membership fees” of at least \$200 from purchasers of universal leases in exchange for the member’s right to participate in litigation later filed by Bustos. (Barrett Dec. (Att. B), at ¶ 7). According to IP Fund, Bustos has recruited approximately 600 defrauded investors representing approximately \$50 million in universal leases to be members in the IP Fund. (IP Fund Motion, at Ex. A, ¶ 18).

7. On March 9, 2007, Bustos created RMG. (Barrett Dec. (Att. B), at ¶ 13). RMG purports to be a limited liability company organized under the laws of the State of Texas whose board of directors is composed of individuals who purchased Universal Leases. (IP Fund Motion at Ex. A, ¶ 135). Although Bustos purportedly resigned from RMG’s board of directors in

³ In total, defendant Kelly paid approximately \$70 million in commissions to brokers related to the sale of universal leases and nine-month promissory notes.

September 2007, he continues to serve as RMG's registered agent and manager. (See Westlaw Corporate Records & Business Registrations, TX800786483, appended hereto as Attachment F).⁴ As a result of its connections to Bustos – a broker who sold the fraudulent instrument at issue in this criminal proceeding – RMG has a conflict of interest with the victims in this case who the special master would be striving to compensate.

8. This is not the first time that Bustos has portrayed himself as the champion of defrauded investors after participating in and profiting from the sale of the very product that defrauded the investors. (SEC Memo (Att. A), at 8). In *Davis v. LifeTime Capital, Inc.*, Case No. 3:04CV0059 (S.D. Ohio), the defendants raised at least \$96 million through the sale of viatical agreements.⁵ In *Lifetime*, as here, Bustos was a broker who earned approximately \$2 million in commissions from selling the viaticals. (SEC Memo (Att. A), at 8). As in the present case, after the viatical investments were discovered to be a fraud, Bustos created an entity also named "IP Fund" and solicited from injured *LifeTime* investors a \$100 payment for membership in the fund. *Id.* In his written communications to *LifeTime* investors, Bustos suggested that the IP Fund would attempt to assert ownership over the viatical agreements that were the subject of the lawsuit, notwithstanding the existence of a judicially appointed receiver. *Id.* Bustos was the subject of a contempt proceeding in the *Lifetime* case and, although the judge did not issue a contempt finding against

⁴ As of November 2007, when the SEC filed its reply memorandum, Bustos was also RMG's Chairman and Secretary. See Intervenor Securities and Exchange Commission's Reply Memorandum in Opposition to Plaintiffs' Application for Appointment of a Temporary Receiver, *IP Fund 1, Inc., et al v. Michael E. Kelly, et al.*, No. 307 CV 1556-P (ND Tex.) (Solis, J.) (hereafter "SEC Reply Memo") (appended hereto as Attachment G), at 2.

⁵ A viatical agreement is accomplished when a third party pays the beneficiary of a life insurance policy a reduced sum in exchange for the right to collect on the policy when the beneficiary dies.

Bustos, she issued the following warning: “[T]his Court is very concerned that Bustos solicited money from the defrauded victims of the LifeTime fraud by convincing them that he knows best despite the benefit of the true facts.” (SEC Memo (Att. A), at 9).

9. Bustos similarly attempted to assert control over the receivership proceedings in *SEC v. Alpha Telecom, Inc. et al.*, Case No. 3:01CV1283 (D. Ore.), which arose from a fraudulent scheme involving the sale of investments in pay telephones promising a high, fixed rate of return, through which approximately \$135 million was fraudulently obtained from 7,000 investors. (SEC Memo (Att. A), at 10). The receiver in that lawsuit brought ancillary summary proceedings against Bustos and approximately 150 other brokers who profited from sales of these fraudulent investments. *Id.* On March 31, 2006, the court ordered Bustos to disgorge \$118,767.50 in commissions. *Id.*⁶ As in the instant case, notwithstanding his obvious conflict, Bustos raised money from approximately 2,000 *Alpha Telecom* investors to create a litigation fund similar to the IP Fund. (SEC Memo (Att. A), at 10).

10. Bustos’ IP Fund has already taken actions undermining the SEC’s enforcement efforts in this case. On September 5, 2007, the SEC filed a civil lawsuit in this district against Michael E. Kelly and numerous other individuals and entities associated with the sale of universal leases requesting, among other relief, the appointment of a receiver to collect and disburse to universal leaseholders any ill-gotten gains disgorged from the defendants. *See United States Securities and Exchange Commission v. Michael E. Kelly, et al.*, 07 C 4979 (N.D. Ill) (Bucklo, J.). One week later,

⁶ Subsequently, the Ninth Circuit Court of Appeals vacated the judgment against Bustos on procedural grounds, holding that the district court lacked *in personum* jurisdiction over Bustos and the other sales agents who appealed the judgment. *See S.E.C. and Thomas F. Lennon, as appointed receiver v. Priscilla Ross et al.*, 2007 WL 2983707, at *1 (9th Cir. Oct. 15, 2007).

despite the fact that the SEC lawsuit, the government's investigation, and Kelly's arrest and detention were public knowledge, IP Fund and Ramey filed a lawsuit in the Northern District of Texas against defendant Michael E. Kelly and others. (*See* SEC Memo (Att. A), at 3; IP Fund Motion, at Ex. A). While the initiation of a lawsuit by victims to recover damages may be appropriate, the IP Fund plaintiffs filed their lawsuit under seal and sought the *ex parte* appointment of the Bustos-controlled RMG as a receiver. (*See* SEC Memo (Att. A), at 3). Fortunately, the judge assigned to IP Fund's lawsuit contacted the SEC to solicit its views on the appointment of RMG as a receiver and, after the SEC intervened in the case, denied IP Fund's request for RMG to be appointed as receiver. (*Id.*; *See* Order, *IP Fund 1, Inc., et al v. Michael E. Kelly, et al.*, No. 307 CV 1556-P (ND Tex.) (Solis, J.), appended hereto as Attachment H). It should also be noted that in its response to the SEC's memorandum, IP Fund represented to the court that "[t]he Department of Justice does not oppose the Plaintiff's lawsuit or the proposed receiver," when in fact IP Fund has never solicited the Department of Justice's approval of their lawsuit or the appointment of their receiver. (*See* IP Fund Response (Att. C), at 5).

11. Bustos' recent attempts to distance himself from RMG do not alter RMG's true nature: a vehicle through which Bustos may profit and also minimize his own exposure and potential liability. Bustos intent in this regard is clearly evidenced in his January 20, 2006, letter to other brokers in which he encouraged other brokers to join together via the IP Fund and seize control over the impending receivership because "even though the Brokers did nothing wrong they need to understand that if you do nothing and a receivership is placed in RHI you will be sued for wrongdoing" (*See* 1/20/06 Letter, appended hereto as Attachment I). Even if Bustos resigned every position he holds with RMG, it is hard to believe that RMG – a creation of Bustos – would be

free from the taint of his influence, rendering RMG irreconcilably conflicted.

Qualifications of RMG's Managers

12. The special master will be responsible to the Court for overseeing the marshaling, safeguarding, sale and repatriation of numerous sophisticated foreign assets – including several hotels, a golf course, a car rental company, and an interest in a significant Mexican real estate development project. It is the announced intention of both the government and defendant Kelly that the court-appointed special master will eventually oversee the distribution of restitution from these assets to thousands of victims. To say that this is a challenging position requiring a highly specialized set of skills and business acumen would be an understatement. The managers of RMG, though apparently victims of the charged scheme who would therefore undoubtedly use their best efforts to accomplish these tasks, are significantly less qualified than the eight candidates who previously submitted written proposals to serve as a special master in this case. RMG's managers do have some general business experience, but none of these individuals appears to have any experience dealing with complicated receiverships, international real estate, or foreign businesses and governments. While it is true that any special master selected by the court would hire certain professionals to assist him or her, RMG's dearth of experience in these specialized fields render RMG an unappealing candidate for this vital position.

WHEREFORE, the United States requests that this Court deny IP Fund's motion for appointment of RMG as a special master.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned Assistant United States Attorney hereby certifies that the following document:

Government's Response to IP Fund's Motion for Appointment of Special Master

was served on October 6, 2008, in accordance with FED. R. CRIM. P. 49, FED. R. CIV. P. 5, LR 5.5, and the General Order on Electronic Case Filing (ECF) pursuant to the district court's system as to ECF filers.

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