

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	)	

**REDACTED FIFTH STATUS REPORT OF THE SPECIAL MASTER**

Douglas A. Doetsch, the court-appointed special master (the “Special Master”) in the case of *United States of America v. Michael E. Kelly*, hereby submits this Fifth Status Report of the Special Master, pursuant to this Court’s Order Appointing Douglas A. Doetsch As Special Master dated February 10, 2009 (the “Order”), to update the Court and interested parties on the status of the Special Master’s progress since October 9, 2009 through January 8, 2009 (the “Reporting Period”) with respect to the goals of his appointment: namely, preserving and repatriating Assets as defined in the Order potentially subject to forfeiture, administering their liquidation, and distributing restitution to the victims of the Defendant.

**I. THE NINETY DAY PLAN OF ACTION**

Under the terms of the Order, the Special Master presented a plan of action within ninety days of the Order date to (a) advise the court of the Special Master’s appraisal and valuation of the assets subject to liquidation for restitution (the “Assets”); (b) determine whether additional funds will be necessary to make full restitution to the victims and pay the fees and expenses of the Special Master and his retained professionals; (c) if necessary, advise the court as to additional steps that need to be taken to investigate, evaluate, obtain and liquidate such Assets; and (d) recommend a methodology, timetable and approximate cost associated with the control, possession and liquidation of the Assets with an end goal of making restitution to the victims (the “Plan of Action”). On June 19, 2009, the Special Master filed his Plan of Action under seal with the Court. The Special Master’s Plan of Action (i) set forth the preliminary results of the diligence and valuation exercise involving the Grupo Kelly entities in Panama and Mexico; (ii) described the optimal legal structure to permit the Special Master to obtain control over the Assets and the companies owning and operating the Assets as a Mexican trust; (iii) identified certain “Exhibit B” assets that could be subjected to the Mexican trust and liquidated if necessary; (iv) addressed issues of victim restitution and sales strategy; and (v) identified potential obstacles and next steps in each of the aforementioned areas.

## II. THE ASSETS

### A. Cash

The Special Master has received a total of USD6,400,000 in cash from Grupo Kelly, which has been deposited in an account maintained by Mayer Brown (the “Special Master’s Trust Account”). Moreover, on December 16, 2009, the Special Master received Court approval to consummate the sale of the Aguascalientes Property (as defined and discussed in Section B.3.a) that was contributed to the Restitution Trust on October 9, 2009. The proceeds of the first payment related to the Aguascalientes Sale received to date were deposited into the Special Master’s Trust Account for the benefit of the victims. Taking into account interest accruals and disbursements to outside professionals for services rendered to the Special Master since December 19, 2009, the balance of cash and investments in the Special Master’s Trust Account as of January 7, 2010 is USD3,889,459.48<sup>1</sup>.

### B. The Assets

#### 1. Formation of the Restitution Trust and Contribution of “Exhibit B” Assets

During the previous Reporting Period, the Special Master, with the assistance of Jáuregui, Navarrete y Nader, S.C. (“JNN”), Mexican counsel to the Special Master, and Arias, Fabrega & Fabrega (“ARIFA”), Panamanian counsel to the Special Master, completed the formation of a trust in Mexico to hold the Assets (the “Restitution Trust”). One salient feature of the final Restitution Trust is that it contemplates the post-execution joinder of assets as necessary to make full restitution to the victims. Accordingly, on October 9, 2009, several Exhibit B Assets (as defined in the Fourth Status Report of the Special Master) were contributed to the Restitution Trust.

#### 2. Unwinding of the Sale of Lot UC-69-2-170

To address the liquidity crisis experienced by Grupo Kelly in light of a sluggish real estate market and generally weak global economy, the Special Master authorized the unwinding of the sale of Lot UC-69-2-170 developed as a part of the [REDACTED] project (“[REDACTED]”) so that [REDACTED] (“[REDACTED]”) could receive the money that it loaned [REDACTED] (“[REDACTED]”) to purchase Lot UC-69-2-170. The Kelly family had previously informed the Special Master of its intention to return the Lot to the available inventory so that the proceeds of its sale could be contributed the Restitution Fund. Similarly, the Kelly family had indicated their desire to return the funds used to purchase the Lot. [REDACTED] was an entity controlled by members of the Kelly family that the Kelly family used to purchase Lot UC-69-2-170. (Lot UC-69-2-170 was sold in accordance with the terms set forth in the Guarantee and Administration Trust among [REDACTED], FONATUR, and Banco Invex, S.A., Institución de Banca Múltiple, Invex Grupo Financiero as Trustee to [REDACTED], for a purchase price of USD2,073,794, which purchase price was funded by a loan from

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<sup>1</sup> This figure does not include \$476,770.48 in disbursements made to outside professionals the week of January 11, 2010 for services rendered in August and September 2009, because the Special Master has not received a bank statement reflecting these payments at the time of filing; *see also* Exhibit A Standardized Fund Accounting Report.

[REDACTED].) The unwinding of the sale of this property provided [REDACTED] with a much-needed cash infusion, and Lot UC-69-2-170 has been returned to the available inventory of lots in [REDACTED], so it may be sold and the proceeds of such sale may be contributed to the Special Master Trust Account.

### **3. The Asset Sale Process: Salient Points**

#### **a. Aguascalientes Property Sale**

On December 16, 2009, the Special Master received the Court's approval to consummate the first sale of property held in the Restitution Trust, and the first payment of USD307,731.20, representing the proceeds of such sale, has been transferred to the Special Master's Trust Account for the benefit of the victims. The property at issue is located in Aguascalientes, Mexico at Miguel de la Madrid S/N Boulevard, F4, Fraccionamiento Misión del Campanario, Municipality of Aguascalientes (the "Aguascalientes Property"). The Aguascalientes Property was sold, through the Special Master, by [REDACTED] to Francisco Cuauhtemoc Piña Alonso, a resident of Mexico, a purchaser identified by Grupo Kelly whose background was reviewed by the United States Attorney's Office ("USAO").

The Aguascalientes Property sale was consummated in accordance with the procedures proposed to the Court on October 27, 2009, through the "Proposed Sale Procedure of the Special Master," which procedures were approved by this Court at the October 28, 2009 Status Hearing<sup>2</sup> (the "Approved Sales Procedure"). FTI Consulting ("FTI") confirmed a valuation performed by Ingeniería Integral de Valuación S.A. de C.V. in its confirmation of valuation letter dated December 15, 2009. The USAO investigated the purchaser's background and possible connections to Grupo Kelly before concluding the purchaser had no apparent connections to Grupo Kelly or to defendant Michael E. Kelly's scheme to defraud investors. The terms of the sale were published in *El Excelsior*, a newspaper of general circulation in Mexico City, Mexico (the publication was initiated on December 2, 2009 and completed on December 11, 2009, thus meeting the 10-calendar-day requirement approved by this Court). Finally, the terms of the sale were presented to this Court and the sale was confirmed at the Confirmation Hearing on December 16, 2009.

#### **b. Form Documentation for Asset Sales**

The documentation portion of the sale process has progressed significantly. The Special Master, in conjunction with FTI and JNN, has developed a form Confidentiality Agreement and Conditional Sale Letter to be distributed to prospective purchasers. Additionally, in selling the Aguascalientes Property, the Special Master developed a form of notice of sale that will be used in complying with the publication requirement for future asset sales and a preliminary form of the Promise to Purchase instrument. The Promise to Purchase instrument has been further refined to contemplate both a sale of real property, as well as a sale of operating companies. This documentation will be used to standardize the Asset sale process in the interest of making Asset sales as efficiently as possible.

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<sup>2</sup> See Minute Order re The Special Master to Utilize the Sales Procedures to Conduct Sales of Discrete Parcels of Real Property, Ct. Doc. #237.

**c. Sales Process for [REDACTED]**

In November 2009, with the assistance of the Grupo Kelly management team, FTI began identifying potential buyers for [REDACTED] in Cancún, Mexico. As a prerequisite to advancing to the diligence phase of the sales process, those buyers who submitted reasonable initial offers for [REDACTED] have each been asked to (i) sign the form Non-Disclosure Agreement and (ii) furnish further information pertaining to its principals and business sufficient to demonstrate its financial ability to consummate a sale in accordance with the proposed terms.

The groups that satisfy these prerequisites will be sent a communication from the Special Master explaining the due diligence process and setting forth the conditions precedent to a final, Court-approved sales transaction, as described in the Approved Sales Procedure.

**d. Meetings in Mexico**

FTI met with Grupo Kelly in Cancún, Mexico on November 5-6, 2009, to review the status of the Bella Vista [REDACTED] project (“[REDACTED]”) and to solicit input from the local brokerage community concerning the current market conditions and the pricing of [REDACTED]. On November 16-17, 2009, the Special Master and FTI met with Grupo Kelly in Cancún to discuss the financial condition of the Grupo Kelly companies.

The Special Master, Grupo Kelly management and FTI met with representatives from several real estate companies and investment funds that expressed interest in acquiring [REDACTED] in Mexico City, Mexico on December 1-2, 2009. The Special Master estimates that the bid solicitation process for the sale of [REDACTED] could begin by February 2010, and that the entire sales process could last 6-9 months. In addition, a substantial tax analysis is underway to thoroughly understand the potential tax consequences of structuring decisions related to the sale of [REDACTED].

**e. Financial Monitoring Process**

FTI attended a meeting with Grupo Kelly in September of 2009 in order to finalize the consolidated Grupo Kelly companies’ cash flow forecast model. This meeting initiated a rolling 13-week company-by-company cash flow model (the “Cash Flow Model”) to forecast income and expenses on a weekly basis (the “Cash Flow Forecast”).

Representatives from FTI met with Grupo Kelly the week of October 5, 2009 to implement the Cash Flow Model. Since this meeting, Grupo Kelly has published the Cash Flow Forecast on a weekly basis to the Special Master and FTI, and the Special Master has hosted a weekly conference call with Grupo Kelly management and FTI to review these forecasts. The Cash Flow Model and Cash Flow Forecast have been effective in highlighting operational strengths and weaknesses within the Grupo Kelly companies and providing the Special Master with up-to-date information to make operational decisions related to the Assets.

**f. Panamanian Issues**

During this Reporting Period, the Special Master has confirmed that there is at least a seasonal cash flow issue at the [REDACTED] (the “[REDACTED]”). Additionally, the Special Master has made progress in addressing the two marketability issues involving the Grupo Kelly corporate entities in Panama that must be resolved prior to the sale of the [REDACTED] asset: (a) corporate irregularities affecting the Panamanian shares that would prove problematic in a sale and (b) a lien linked to a payable owed to the current manager of the [REDACTED] property.

With respect to the first marketability issue, under the terms of the Restitution Trust the corporate irregularities affecting the shares of the Panamanian entities subject to the Restitution Trust must be rectified by April 23, 2010. The Special Master understands that the status of the corporate records in Panama is linked to an outstanding payable for legal services rendered by Bufete Lescure, a Panamanian law firm and counsel to Grupo Kelly. Specifically, Panamanian legal counsel was receiving monthly payments relating to (a) the administration of a lease repayment program and (b) the administration of certain ongoing corporate litigation. The Special Master has worked with ARIFA to produce a settlement agreement with payment of Bufete Lescure tied to (i) the rectification of all Panamanian corporate irregularities and (ii) the sale of the [REDACTED].

With respect to the second marketability issue, the USD2,000,000<sup>3</sup> debt obligation owed to the general manager of the [REDACTED] has been documented in a draft contract between the general manager (who represents that he has run the hotel business and invested his personal funds in its infrastructure and operations as a “personal favor” to the Defendant) and Grupo Kelly. Upon execution of this contract, all potential claims by such general manager or his affiliates would be extinguished. Moreover, this payable will not be paid until the [REDACTED] is sold. This contract is currently under review by the general manager of the [REDACTED] and its counsel.

### **III. THE VICTIMS**

#### **A. The Universal Lease Files**

The Universal Lease files have been produced by Grupo Kelly and have been scanned by the USAO. The USAO conducted an audit of the calculation of the victims’ restitution claims provided by Grupo Kelly against the Universal Lease information the USAO has received directly from the victims in October-December 2009. Generally, the USAO’s audit found that the information provided by Kelly was consistent with the information provided by the victims.

The Special Master and the Special Master’s Claim Processing Agent (“Stenger”), in consultation with the USAO, are in the process of drafting a proposed Order to Establish Preliminary Procedure of Determination of Kelly Victim Claims (“Claims Procedure Order”), for approval by this Court. Once the Claims Procedure Order is in place, the Special Master and Stenger will send each victim a Victim Claim Form with the total restitution amount that each

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<sup>3</sup> Note that this figure is different from that provided in the Plan of Action because the payable was initially represented as constituting approximately USD3,500,000 to USD4,000,000 versus the USD2,000,000 contemplated under the draft contract.

victim is entitled to receive should the Special Master be able to make full restitution to all victims (the "Total Restitution Amount"),<sup>4</sup> as well as an explanation of how the Special Master and Stenger reached that value. Each victim will then be required to either approve the calculated Total Restitution Amount or ask for a recalculation of the Total Restitution Amount. The Victim Claim Form will also require the victims to terminate their leases and release their claims on the properties themselves to allow the properties to be sold free and clear of all liens and/or liabilities, to receive the maximum value possible. Any claims a victim might have against Michael E. Kelly in his personal capacity, however, will not be affected by this release.

### **B. Victim Communication**

Very few victims have contacted the Special Master at this point and the Special Master has not had cause to contact victims himself. Any victim who has contacted the Special Master directly was referred to the resources provided by the USAO, which include:

1) a telephone line established by the USAO dedicated to addressing victims' questions. The telephone number associated with such phone line is: (866) 364-2621;

2) an email address established by the USAO dedicated to addressing victims' questions. The email address is as follows: [USAILN-Victim.MK@usa.doj.gov](mailto:USAILN-Victim.MK@usa.doj.gov);

3) for victims who have already been identified, the USAO has created a password protected website, [www.notify.usdoj.gov](http://www.notify.usdoj.gov), which victims can access with a Victim Identification Number ("VIN") and Personal Identification Number ("PIN") provided to them by the USAO. Victims should call (866) 625-1631 if they have any problems accessing such website;

4) for victims who have already been identified and do not have access to the internet, the USAO has also established a call center, (866) DOJ-4YOU (1-866-365-4968), which victims can access with the same VIN and PIN provided to them by the USAO.

### **IV. CONTINUING STRATEGY**

The Special Master will continue his efforts on transferring control of the Assets to the Restitution Trust or otherwise taking control of additional assets or the proceeds therefrom, analyzing the value and sale prospects of Assets, preparing a sales strategy for the various Assets and facilitating the sale of such Assets. Additionally, the Special Master continues to engage in regular discussions with Grupo Kelly regarding the financial performance of the Assets.

### **CONCLUSION**

The Special Master shall continue to perform his responsibilities and duties consistent

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<sup>4</sup> The Total Restitution Amount will be the basis for the claim; however, the amount of the actual distribution received by each victim will be reduced depending on the amount of funds available for distribution. All victims will receive a pro rata share of the proceeds available for restitution if there are not enough proceeds from the liquidation of the Assets to make full restitution to all victims, provided they have not already received distributions greater than their pro rata share.

with the Order and all other directives of this Court.

RESPECTFULLY SUBMITTED this **20th day of January, 2010.**

/s/ Douglas A. Doetsch

Douglas A. Doetsch, Special Master

**Exhibit A**

**Standardized Fund Accounting Report**



STANDARDIZED FUND ACCOUNTING REPORT for Michael Kelly Restitution Fund - Cash Basis

Criminal Court Case No. 06 CR 964

Reporting Period 09/30/2009 to 01/07/2010

FUND ACCOUNTING (See Instructions):				
		Detail	Subtotal	Grand Total
Line 1	Beginning Balance (As of 09/30/2009):	\$3,757,199.87	\$3,757,199.87	\$3,757,199.87
	<i>Increase/ Decreases in Fund Balance:</i>			
Line 2	Business Income	-	-	-
Line 3	Cash and Securities	-	-	-
Line 4	Interest / Dividend Income/ Loss	971.57	971.57	971.57
Line 5	Business Asset Liquidation	307,731.20	307,731.20	307,731.20
Line 6	Personal Asset Liquidation	-	-	-
Line 7	Third-Party Litigation Income	-	-	-
Line 8	Miscellaneous - Other (transferred by the defendant)	-	-	-
	<b>Total Funds Available (Lines 1 – 8):</b>	<b>\$4,065,902.64</b>	<b>\$4,065,902.64</b>	<b>\$4,065,902.64</b>
	<i>Decreases in Fund Balance:</i>			
Line 9	Disbursements to Investors	-	-	-
	<b>Total Disbursements for Receivership Operations</b>	-	-	-
Line 10	<b>Disbursements for Distribution Expenses Paid by the Fund:</b>	-	-	-
	1. Fees:			
	Special Master (including related U.S. legal fees and expenses).....	\$74,615.58	\$74,615.58	\$74,615.58
	Independent Distribution Consultant (IDC).....	-	-	-
	Distribution Agent.....	-	-	-
	Consultants.....	\$48,949.00	\$48,949.00	\$48,949.00
	Other Legal Advisers.....	\$52,878.58	\$52,878.58	\$52,878.58
	Tax Advisers.....	-	-	-
	Claims Processing.....	-	-	-
	2. Administrative Expenses	-	-	-
	3. Miscellaneous (wire transfer fee)	-	-	-
Line 11	<b>Disbursements to Court/Other:</b>	-	-	-
Line 11a	Investment Expenses/Court Registry Investment System (CRIS) Fees	-	-	-
Line 11b	Federal Tax Payments	-	-	-
	<b>Total Disbursements to Court/Other:</b>	-	-	-
	<b>Total Funds Disbursed (Lines 9 – 11):</b>	<b>\$176,443.16</b>	<b>\$176,443.16</b>	<b>\$176,443.16</b>
Line 12	<b>Ending Fund Balance (As of 01/07/2010):</b>			<b>\$3,889,459.48</b>
Line 12a	Cash and Cash Equivalents			\$591,341.25
Line 12b	Investments			\$3,298,118.23

NOTE

NOTE: The Interest / Dividend Income / Loss amount is calculated by difference since detailed bank statements are not available as at 01/07/2010.

OTHER SUPPLEMENTAL INFORMATION:				
		Detail	Subtotal	Grand Total
<b>Line 14</b>	<b>Report of Items NOT To Be Paid by the Fund:</b>			
	<b>Disbursements for Plan Administration Expenses Not Paid by the Fund:</b>			
Line 14a	Plan Development Expenses Not Paid by the Fund:			
	1. Fees:			
	Special Master (including related U.S. legal fees and expenses).....			
	IDC.....			
	Distribution Agent.....			
	Consultants.....			
	Other Legal Advisers.....			
	Tax Advisers.....			
	2. Administrative Expenses			
	3. Miscellaneous			
	Total Plan Development Expenses Not Paid by the Fund			
Line 14b	Plan Implementation Expenses Not Paid by the Fund:			
	1. Fees:			
	Special Master (including related U.S. legal fees and expenses).....			
	IDC.....			
	Distribution Agent.....			
	Consultants.....			
	Other Legal Advisers.....			
	Tax Advisers.....			
	2. Administrative Expenses			
	3. Investor Identification:			
	Notice/Publishing Approved Plan.....			
	Claimant Identification.....			
	Claims Processing.....			
	Web Site Maintenance/Call Center.....			
	4. Special Master (including related U.S. legal fees and expenses) Bond			
	5. Miscellaneous			
	6. FAIR Reporting Expenses			
	Total Plan Implementation Expenses Not Paid by the Fund			
Line 14c	Tax Administrator Fees & Bonds Not Paid by the Fund			
	<b>Total Disbursements for Plan Administration Expenses Not Paid by the Fund</b>			
<b>Line 15</b>	<b>Disbursements to Court/Other Not Paid by the Fund:</b>			
Line 15a	Investment Expenses/CRIS Fees			
Line 15b	Federal Tax Payments			
	<b>Total Disbursements to Court/Other Not Paid by the Fund:</b>			
<b>Line 16</b>	<b>DC &amp; State Tax Payments</b>			
<b>Line 17</b>	<b>No. of Claims:</b>			
Line 17a	# of Claims Received This Reporting Period.....	0	0	0
Line 17b	# of Claims Received Since Inception of Fund.....	0	0	0
<b>Line 18</b>	<b>No. of Claimants/Investors:</b>			
Line 18a	# of Claimants/Investors Paid This Reporting Period.....	0	0	0
Line 19b	# of Claimants/Investors Paid Since Inception of Fund.....	0	0	0

Special Master:

By: \_\_\_\_\_  
(signature)

\_\_\_\_\_  
(print)

\_\_\_\_\_  
(title)

Date: \_\_\_\_\_