

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 FOURTH 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 Fourth 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 June 19, 2009 through October 9, 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 is to present a plan of action within ninety (90) 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 already subject to liquidation for making restitution; (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, taking into account the possible legal and tax implications inherent in the transfer of such control, and ultimately 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 the 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 US \$6,400,000 in cash from Grupo Kelly, which has been deposited in an account maintained by Mayer Brown (the “Special Master’s Trust Account”). 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 September 30, 2009 is US \$3,757,199.87¹.

B. The Assets

1. Formation of the Restitution Trust

During the Reporting Period, the Special Master, with the assistance of Jauregui, Navarrete y Nader S.C. (“JNN”), Mexican counsel to the Special Master, and Arias, Fabrega & Fabrega (“ARIFA”), Panamanian counsel to the Special Master, the Special Master completed the formation of a trust in Mexico to hold the Assets (the “Restitution Trust”) on July 17, 2009. 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 below) were contributed to the Restitution Trust. *See* related discussion in Section B.2 below.

2. “Exhibit B” Assets

The Plan of Action attached as Exhibit B thereto a list of additional assets that emerged in the diligence process (the “Exhibit B Assets”). As a result of discussion with the Special Master, when the Plan of Action was filed with this Court Grupo Kelly had already committed to contribute to the Restitution Trust several Exhibit B Assets: [REDACTED]. Prior to the Special Master’s September Meetings in Mexico, the Special Master requested and received Grupo Kelly’s plan for contributing the balance of the Exhibit B Assets to the Restitution Trust. (*See Exhibit A* hereto, received from Grupo Kelly.) While some of the originally identified Exhibit B Assets were represented to the Special Master during the September Meetings as having been previously sold or as being currently encumbered, the Special Master is verifying this status of all Exhibit B Assets with the cooperation of Grupo Kelly and the assistance of JNN. As a general matter, the Special Master requested that unencumbered assets be contributed to the Restitution Trust or otherwise made available to the Special Master as soon as possible. To that end, Grupo Kelly and the Special Master and his counsel have worked to complete diligence relating to the contribution of the shares and the related assets set forth on Exhibit B hereto. Such contributions were effectuated on October 9, 2009.

¹ As of 9/30/09; *see also* Exhibit C Standardized Fund Accounting Report.

3. Meetings in Mexico

Representatives from FTI met with Grupo Kelly on August 20, 2009 to discuss the updated projections for [REDACTED], which projections illustrated a significant liquidity problem at the end of fiscal year 2009. The severity of this liquidity crisis was further discussed in the meetings taking place from September 9, 2009 to September 11, 2009, during which the Special Master was in attendance (the “September Meetings”).

During the September Meetings, the Special Master, a Mayer Brown attorney and representatives from FTI met with Grupo Kelly in Cancún to discuss (a) sales strategy for all Assets, including a discussion of the need for a universal lease release in respect of the Mexican hotel properties; (b) cash flow and liquidity issues relating to the consolidated group of companies ([REDACTED]); (c) cash flow forecasting and the monitoring process; (d) the terms of the conveyance of the Lot UC-69-2-170 (*e.g.*, whether its shares would be sold through a special power of attorney or conveyed to the Restitution Trust and sold through this structure); (e) the status of (i) the corporate irregularities affecting the Panamanian shares subject to the Restitution Trust and (ii) the lien linked to a payable due the current manager of the [REDACTED]; and (f) the status of the [REDACTED] required to contributed assets relating to the [REDACTED] and [REDACTED]. The September Meetings also included a tour of the Grupo Kelly [REDACTED]. The remainder of this Status Report provides this Court with the status of each of these action items included in the September Meetings agenda as of the date hereof.

a. Sales Strategy and the Universal Lease Issue

The September Meetings provided an initial forum for a discussion of sales strategy for each of the Assets. At this time, Grupo Kelly provided the Special Master with their proposed sales strategy to address the significant cash flow shortfall expected in the immediate term and a list of targeted net sales proceeds relating to each relevant Asset. The proposed sales strategy set forth a list of unencumbered assets (including some Exhibit B Assets, *see* discussion at Section II.B.2) that Grupo Kelly could sell in the short term at a discount; the list also assumed a discount rate of 20% relating to the payment of existing liabilities and/or taxes that would become due upon sale. On September 10, 2009, the Special Master authorized the implementation of such sales strategy. In addition to such proposed sales strategy, Grupo Kelly anticipated evaluating cost-cutting measures and potential expense deferral opportunities as well as strategies to collect on outstanding receivables owed in respect of developers in Puerto Cancún. The Assets would generally be sold through private brokers, the Grupo Kelly network within the respective Mexican and Panamanian real estate markets, FTI’s and Mayer Brown’s contacts among potential hospitality and real estate investors, or a combination of these approaches.

With respect to the existing universal leases, Mexican and Panamanian counsel have advised us that a release should be obtained from as many universal leaseholders as possible in regard to their universal leasehold interests in the Grupo Kelly Mexican hotel properties. The Special Master prepared a form of release approved by Mexican and Panamanian counsel. The release, which features a waiver of all universal leaseholder rights under Mexican and Panamanian law, remains subject to the review and comment of the Special Master’s claims

processing agent, Stenger & Stenger (“Stenger”) and the US Attorney’s Office (“USAO”). Please note that JNN has advised that, though the releases are commercially advisable practice, they are not strictly necessary for the legal sale of the properties to a third party (though it is doubtful that any such third party would purchase them without the releases in place).

ii. [REDACTED]

[REDACTED] has been experiencing cash flow challenges since being contributed to the Restitution Trust. During the September Meetings, the Special Master and Grupo Kelly agreed that Grupo Kelly would complete construction of “Phase I” of the [REDACTED] and explore options relating to creating a façade for [REDACTED] that would involve encapsulating the building framework to save the cost of completing a full construction. Since the September Meetings, the Special Master has approved periodic transfers of funds from [REDACTED] (the owner corporation) to advance the construction of [REDACTED]. This decision was made taking into account the proximity of the [REDACTED] project (the most valuable Asset) and the close association of this project with the Grupo Kelly brand, both considerations that tie into preserving the value in the [REDACTED] (as well as the sale of the other Assets). The completion of the agreed construction in [REDACTED] is threatened by the cash shortfall affecting the consolidated Grupo Kelly companies, and specifically [REDACTED].

iii. Cash Flow Strategy and the Monitoring Process

Although the September Meetings served as a platform for the discussion of the cash flow strategy and the financial monitoring process of Grupo Kelly, FTI, together with the Special Master, has done significant work in this arena since such initial discussions. To effectuate the monitoring role contemplated by this Court’s order, FTI attended a follow-up meeting with Grupo Kelly the week after the September Meetings in order to finalize the consolidated Grupo Kelly companies’ cash flow forecast model. This meeting initiated the rolling 13-week company-by-company cash flow model (the “Monitoring Cash Flow”) to forecast inflows and expenses and also to highlight upcoming potential risks associated with a particular Asset.

Representatives from FTI met with Grupo Kelly the week of October 5, 2009 to implement the first phases of the Monitoring Cash Flow.

iv. [REDACTED]

Although other options were also considered, the parties ultimately decided that the shares of the corporate owner of [REDACTED] would be contributed to the Restitution Trust; such shares were contributed on October 9, 2009. *See* discussion in Section II.B.2 above.

v. Panamanian Issues

Within this reporting period, the Special Master has learned that there is at least a seasonal cash flow issue at the [REDACTED]. Additionally, there are two merchantability 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]. During a visit to Panama the week of September 28, 2009, a representative from FTI and a member of Grupo Kelly senior management addressed these specific issues as well as issues relating to the cash flow forecast for the remaining three months of the fiscal year and the pending 2008 financial statements.

With respect to the first merchantability 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 October 17, 2007. 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, Panamanian counsel to Grupo Kelly. 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]. After paying a \$25,000 installment towards this settlement agreement, Bufete Lescure has agreed to rectify the corporate irregularities in the Panamanian shares that would thwart a sale of the [REDACTED].

With respect to the second merchantability issue, the [REDACTED]² debt obligation 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 the relevant Grupo Kelly employing entity, which contract only permits payment in full of such payable in a scenario where the [REDACTED] sells in excess of [REDACTED] (note that FTI’s estimated market value ranged from approximately [REDACTED] to [REDACTED]). 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. The contract has been finalized and is being translated so that it might be reviewed by the general manager (who is an English speaker).

vi. FONATUR Consent

On September 17, 2009, Alberto Zinser, Mexican counsel to Grupo Kelly, met with [REDACTED]. In anticipation of this meeting, the Special Master, Grupo Kelly and their respective counsel prepared a memorandum outlining the mechanics and the ends of the Restitution Trust, with a particular focus on the [REDACTED]. On October 1, 2009, Christian Zinser of the Grupo Kelly legal team confirmed that [REDACTED] provided its consent to the transfer of the shares of [REDACTED]. This consent permits the contribution of the assets owned by [REDACTED] to the Restitution Trust, most notably the shares representing Grupo Kelly’s ownership interest in the [REDACTED]. The Special Master has received a written copy of the consent of [REDACTED] and the relevant shares and assets have been transferred to the Restitution Trust as of October 9, 2009.

III. THE VICTIMS

A. The Universal Lease Files

² Note that this figure is different from that provided in the Plan of Action because the payable was initially represented as constituting approximately [REDACTED] to [REDACTED] in invested funds (a loan) and a [REDACTED] success fee.

The Universal Lease files have been produced by Grupo Kelly and have been scanned by the United States Attorney's Office ("USAO"). The USAO intends to conduct an audit of the calculation of the victims' restitution claims provided by Kelly against the Universal Lease information the USAO has received directly from the victims. In the meantime, the Special Master and Stenger are in the process of drafting a proposed Order to Establish Preliminary Procedure of Determination of Kelly Victim Claims ("Preliminary Order") for approval by this Court. Once a Preliminary Order is in place, the Special Master and Stenger will send each victim a Victim Claim Form with the total restitution amount that each victim is entitled to (the "Total Restitution Amount")³ and an explanation of how the Special Master and Stenger reached that value. Each victim will then have to either approve or ask for a recalculation of the Total Restitution Amount. In addition, the Victim Claim Form will ask the victims to terminate their leases and release their claims on the properties themselves to allow the properties to be sold vacated, 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;
- 3) for victims who have already been identified, the USAO has created a password protected website, 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

Going forward, the Special Master will continue to focus his efforts on transferring

³ The Total Restitution Amount will be the basis for the claim, however, the amount of the actual distribution received by each victim *may* 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.

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 discussions with Grupo Kelly regarding cash shortfalls in the operations as well as strategies to accelerate sales and reduce spending.

CONCLUSION

The Special Master shall continue to perform his responsibilities and duties consistent with the Order and all other directives of this Court.

RESPECTFULLY SUBMITTED this **12th day of October, 2009**.

/s/ Douglas A. Doetsch

Douglas A. Doetsch, Special Master

Exhibit A

Grupo Kelly Exhibit B Response

[REDACTED]

Exhibit B

[REDACTED]

Exhibit C

Standardized Fund Accounting Report

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

Criminal Court Case No. 06 CR 964
Reporting Period 05/07/2009 to 09/30/2009

FUND ACCOUNTING (See Instructions):				
		Detail	Subtotal	Grand Total
Line 1	Beginning Balance (As of 05/07/2009):	\$6,408,286.38	\$6,408,286.38	\$6,408,286.38
	Increase/ Decreases in Fund Balance:			
Line 2	Business Income	-	-	-
Line 3	Cash and Securities	-	-	-
Line 4	Interest / Dividend Income/ Loss	7,013.35	7,013.35	7,013.35
Line 5	Business Asset Liquidation	-	-	-
Line 6	Personal Asset Liquidation	-	-	-
Line 7	Third-Party Litigation Income	-	-	-
Line 8	Miscellaneous - Other (transferred by the defendant)	-	-	-
	Total Funds Available (Lines 1 – 8):	\$6,415,299.73	\$6,415,299.73	\$6,415,299.73
	Decreases in Fund Balance:			
Line 9	Disbursements to Investors	-	-	-
	Total Disbursements for Receivership Operations	-	-	-
Line 10	Disbursements for Distribution Expenses Paid by the Fund:	-	-	-
	1. Fees:			
	Special Master (including related U.S. legal fees and expenses).....	\$971,206.21	\$971,206.21	\$971,206.21
	Independent Distribution Consultant (IDC).....	-	-	-
	Distribution Agent.....	-	-	-
	Consultants.....	\$1,205,257.13	\$1,205,257.13	\$1,205,257.13
	Other Legal Advisers.....	\$393,209.88	\$393,209.88	\$393,209.88
	Tax Advisers.....	-	-	-
	Claims Processing.....	\$88,401.64	\$88,401.64	\$88,401.64
	2. Administrative Expenses	-	-	-
	3. Miscellaneous (wire transfer fee)	\$25.00	\$25.00	\$25.00
Line 11	Disbursements to Court/Other:	-	-	-
Line 11a	Investment Expenses/Court Registry Investment System (CRIS) Fees	-	-	-
Line 11b	Federal Tax Payments	-	-	-
	Total Disbursements to Court/Other:	-	-	-
	Total Funds Disbursed (Lines 9 – 11):	\$2,658,099.86	\$2,658,099.86	\$2,658,099.86
Line 12	Ending Fund Balance (As of 09/30/2009):			\$3,757,199.87
Line 12a	Cash and Cash Equivalents			\$2,075,363.44
Line 12b	Investments			\$1,681,836.43

OTHER SUPPLEMENTAL INFORMATION:				
		Detail	Subtotal	Grand Total
Line 14	Report of Items NOT To Be Paid by the Fund:	-	-	-
	Disbursements for Plan Administration Expenses Not Paid by the Fund:	-	-	-
<i>Line 14a</i>	<i>Plan Development Expenses Not Paid by the Fund:</i>	-	-	-
	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	-	-	-
	<i>Total Plan Development Expenses Not Paid by the Fund</i>	-	-	-
<i>Line 14b</i>	<i>Plan Implementation Expenses Not Paid by the Fund:</i>			
	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	-	-	-
	<i>Total Plan Implementation Expenses Not Paid by the Fund</i>	-	-	-
<i>Line 14c</i>	<i>Tax Administrator Fees & Bonds Not Paid by the Fund</i>	-	-	-
	Total Disbursements for Plan Administration Expenses Not Paid by the Fund	-	-	-
Line 15	Disbursements to Court/Other Not Paid by the Fund:			
<i>Line 15a</i>	<i>Investment Expenses/CRIS Fees</i>	-	-	-
<i>Line 15b</i>	<i>Federal Tax Payments</i>	-	-	-
	Total Disbursements to Court/Other Not Paid by the Fund:	-	-	-
Line 16	DC & State Tax Payments	-	-	-
Line 17	No. of Claims:			
<i>Line 17a</i>	<i># of Claims Received This Reporting Period.....</i>	0	0	0
<i>Line 17b</i>	<i># of Claims Received Since Inception of Fund.....</i>	0	0	0
Line 18	No. of Claimants/Investors:			
<i>Line 18a</i>	<i># of Claimants/Investors Paid This Reporting Period.....</i>	0	0	0
<i>Line 19b</i>	<i># of Claimants/Investors Paid Since Inception of Fund.....</i>	0	0	0

Special Master:

By: _____
(signature)

(print)

(title)

Date: _____