

**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	)	

**THIRTEENTH 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 Thirteenth 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 from October 24, 2011 through January 10, 2012 (the “Reporting Period”) with respect to the goals of his appointment: namely, preserving and repatriating Assets (as defined below) potentially subject to forfeiture, administering their liquidation, and distributing the proceeds of such liquidated Assets to the victims of the Defendant.

**I. THE ORIGINAL PLAN OF ACTION**

Under the terms of the Order, the Special Master presented a plan of action to this Court on June 19, 2009 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 “Original Plan of Action”).

The Special Master’s Original 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 would be subjected to the Mexican trust and liquidated, if necessary to make restitution; (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 received a total of USD6,400,000 in cash from Grupo Kelly on February 24, 2009, which was deposited in an account maintained by Mayer Brown (the “Special”

Master's Operating Account"), from which professional fees incurred in connection with making restitution for the victims are paid. On December 16, 2009, the Special Master received Court approval to consummate the sale of the Aguascalientes Property (as described in a prior Status Report submitted to the Court and defined below). The proceeds related to the Aguascalientes sale were deposited into the Special Master's Sales Proceeds Account (the "Special Master's Sales Proceeds Account") for the benefit of the victims.

Taking into account interest accruals and disbursements to outside professionals for services rendered to the Special Master, as of December 30, 2011, the balance of cash and investments in the Special Master's Operating Account was USD395,420.22, and the balance of sale proceeds in the Special Master's Sales Proceeds Account was USD6,953,632.50.

## **B. The Assets**

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

On July 17, 2009, the Special Master, with the assistance of Jáuregui y Navarrete, S.C. ("JN," formerly known as Jáuregui, Navarrete y Nader or 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 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. The Special Master has held discussions with the U.S. Attorney's Office (the "USAO") to consider other Assets that may be suitable for contribution to the Restitution Trust depending on the value of the Asset versus the cost of adding the Asset to the Restitution Trust. Where the cost of adding an Asset to the Restitution Trust is too high compared to the value of the Asset, such Assets may be sold outside of the Restitution Trust and the proceeds turned over to the Special Master to be applied to restitution.

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

#### **a. Tax Review**

The Special Master, with the assistance of Del Valle Torres ("DVT"), Mexican tax counsel to the Special Master, has invested significant time in analyzing the tax implications of a potential sale of the various Mexican Assets currently subject to the Restitution Trust. This analysis has involved reviewing the balance sheets and tax accounts of the various Grupo Kelly corporations organized under the laws of Mexico and, in particular, focusing on the substantial intercompany accounts and how to best address such intercompany balances in order to minimize adverse tax consequences for the disposition of Assets and for the transfer of proceeds resulting from such disposition to the Restitution Trust.

The Special Master undertook a similar exercise in Panama in connection with the proposed sale of the Avalon Grand Panama (as defined and further discussed below).

**b. Turistica Kelly Sale**

The Turistica Kelly Property is a large warehouse, office building, and manager's house located in Cancún, Mexico ("Turistica Kelly") that was sold on May 27, 2011. The Special Master may realize some additional minimal proceeds from the sale of certain equipment that is currently stored rent-free inside the warehouse and the Special Master continues to market this equipment.

**c. Puerto Cancún**

The Special Master and his advisors initiated the sales process for the Puerto Cancún project in 2010. The Special Master and Frontera identified and contacted approximately 45 potential purchasers of Puerto Cancún in the first quarter of 2010. Beginning in late March 2010, information packages were distributed to interested parties in anticipation of conducting a due diligence process. In late April 2010, a number of such parties submitted non-binding letters of interest and preliminary bids, and in early May 2010, a subset of such group was granted data room access to conduct due diligence on the property.

In August and September 2010, potential bidding groups attended multi-day management meetings and presentations in Cancún, Mexico. The Special Master presented the potential bids, as well as the possibility of an alternative to a bulk sale that would involve the continued sales of individual lots by the Puerto Cancún management, the Special Master, and Frontera, to this Court in December 2010 and January 2011.

After consultation with the Court, the USAO, the defense, the Special Master, and the chosen bidder, MIRA, an affiliate of the Black Creek Group ("MIRA"), entered into negotiations to finalize an agreement on the terms of a potential sale of Puerto Cancún for USD65,000,000, subject to certain purchase price adjustments and holdbacks (the "Original Sale Terms"). The Original Sale Terms were presented to the Court on May 2, 2011, and the Special Master was authorized to enter into the agreement with MIRA on May 31, 2011, subject to publication and final approval by the Court. Furthermore, the USAO sent a summary of the Original Sale Terms to the victims on May 4, 2011 through the Victim Notification System ("VNS").

The Special Master published MIRA's bid and the material negotiated terms in two major newspapers in Mexico, *Novedades* and *El Universal*, as well as *The Wall Street Journal*, in an effort to solicit bids on more favorable terms. The publication yielded a counteroffer of USD71,600,000 (subject to certain other purchase price adjustments and holdbacks) (the "Counteroffer"). On June 29, 2011, the Special Master participated in meetings in Mexico with the Mexican real estate investment fund presenting the Counteroffer. At substantially the same time, MIRA increased its bid to USD70,000,000 (subject to certain purchase price adjustments and holdbacks). After consultation with the USAO and this Court, the Special Master accepted MIRA's bid of USD70,000,000 on June 30, 2011.

On July 1, 2011, the USAO sent victims an update through the VNS summarizing the terms of the Counteroffer and the revised bid received from MIRA, which also noted that the Special Master, after consultation with the Court and the USAO, had accepted the revised MIRA bid. On July 6, 2011, the USAO sent a final update to victims notifying them that the Court had

authorized the Special Master to proceed subject to interested persons submitting comments and final approval by the Court. The notice invited victims to send any comments that they might have to the USAO no later than June 13, 2011. All comments received by the USAO were submitted to the Court for its consideration.

On July 14, 2011, after hearing from the Special Master, the USAO, the defense, and all other interested parties, the Court approved the sale of Puerto Cancun to MIRA for USD70,000,000 (subject to certain purchase price adjustments and holdbacks) (the "Pre-Diligence Sale Terms"). However, several due diligence issues remained unresolved. The Special Master filed a summary of these issues with the Court on September 30, 2011. Upon the request of the Special Master, the Court granted a series of extensions until November 18, 2011 for MIRA to complete their diligence and commit to purchase Puerto Cancun subject only to the completion of the remaining conditions precedent to closing.

After completion of their due diligence, MIRA brought their findings to the Special Master and requested certain price adjustments for the purchase of Puerto Cancun. On November 18, 2011 the Special Master and MIRA entered into a preliminary revised agreement for the sale of Puerto Cancun for USD59,500,000 (subject to certain purchase price adjustments and holdbacks, which are more extensive than those that applied to the purchase price under the Pre-Diligence Sale Terms) (the "Final Sale Terms"). On November 18, 2011, after hearing from the Special Master, USAO, the defense, and all other interested parties, the Court approved the sale of Puerto Cancun the MIRA according to the Final Sale Terms.

**d. Financial Monitoring Process**

Since the beginning of October 2009, Grupo Kelly has provided the Special Master and Frontera, on a weekly basis, a rolling 13-week company-by-company cash flow model (the "Cash Flow Model") to forecast income and expenses (the "Cash Flow Forecast"). The Special Master held a conference call with Grupo Kelly management and Frontera on a weekly basis 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, identifying potential cost-savings opportunities, and providing the Special Master with up-to-date information to make operational decisions in order to maintain the value of the Assets.

Now that the sale of Puerto Cancun has been approved, the Special Master has been holding this call with Grupo Kelly on a biweekly basis.

**e. Bella Vista**

The Special Master and Frontera have been in discussions with Grupo Kelly regarding the future of the Bella Vista Towers project ("Bella Vista"). The parties are analyzing the viability of the construction of Towers 3 and 4 at Bella Vista. Bella Vista was originally designed to consist of four condominium towers (approximately 232 condominium units) adjacent to the Puerto Cancun Project. Towers 1 and 2 have been completed and a limited number of residents moved into those towers earlier this year. The internal structure for Tower 3 has been erected, but the tower is not yet ready for residents at this time. Construction of Tower 4 has not started; however, condominiums in all four towers have been sold and binding

contracts are in place in connection with such sales. As of January 2012, approximately 75.4%, 70.7%, 69.0%, and 52.7% of the available condominium units in Towers 1, 2, 3 and 4, respectively, have been sold.

Grupo Kelly estimates that Bella Vista will require approximately USD11,800,000 in additional funds to complete construction of Tower 3. Economic conditions and unmet developer apartment delivery commitments have combined to produce a slow sales pace at Bella Vista, and as such, the project will not be able to self-finance the construction of Tower 3. The Special Master, along with Grupo Kelly, determined to invest the resources necessary to finalize at least the first two towers in Bella Vista because it serves as a visible “flagship” element for all of the Puerto Cancún Project, in part because it is located adjacent to the main entrance of the Puerto Cancún Project. In October 2010, Bella Vista was awarded second place (out of 57 comparable developments) in the Cemex Building Awards.

The Special Master is analyzing the legal documentation related to Bella Vista purchasers provided by Grupo Kelly to determine which units should be delivered and whether there are any defaulting purchasers. This analysis will inform the decisions as to whether to finish Tower 3 and to construct Tower 4. An initial group of condominium buyers was offered delivery of their Bella Vista units in 2010. As of January 6, 2012, 29 deliveries have been made to condominium buyers in Towers 1 and 2 and an additional 27 units have been approved for delivery in the near future. The Special Master has narrowed down the number of buyers for whom there does not appear to be any proof of payment and is currently reaching out to those who have not submitted evidence of payment for their unit.

The condominium regime for Bella Vista, which was approved at the municipal level in October 2011, was recently approved at the state level and will be registered in the Public Registry near the end of January 2012. Once the condominium regime is fully registered, the Special Master can begin issuing deeds for the property.

Certain units at Bella Vista were purchased with funds that victims originally invested in the Universal Lease scheme and then asked to have transferred towards the purchase of a Bella Vista unit (such funds are referred to herein as “Rollovers”). Acknowledgement of the Rollovers as valid payments towards units at Bella Vista would allow those victims to benefit at the expense of all other victims. In November 2011, the Special Master proposed to Magistrate Judge Denlow that the Rollovers should not be acknowledged as legitimate payments towards Bella Vista units but should instead be submitted as claims for restitution, as are all other Universal Lease investments. On December 21, 2011, Magistrate Judge Denlow issued a report and recommendation adopting the Special Master’s proposal.

#### **f. Panamanian Issues**

During this Reporting Period, the Special Master has worked with ARIFA, Panamanian counsel to the Special Master, and Frontera to seek potential purchasers for the Avalon Grand Panama Hotel (the “Avalon Grand Panama”). By the end of 2011, a group of Venezuelan investors showed interest in purchasing the Avalon Grand Panama. Despite their interest, the sale of the Avalon Grand Panama did not occur as the Venezuelan group failed to obtain appropriate financing for the purchase.

With the assistance of a Panamanian labor counsel and ARIFA, the Special Master has formalized all outstanding labor obligations of the Avalon Grand Hotel so that the hotel complies with mandatory Panamanian regulations. The Special Master has also managed to reduce the operational costs of the Avalon Grand Panama by reducing the number of employees working at the hotel.

The Special Master and Frontera organized and updated the financial statements of each of the Panamanian entities formerly administered by Grupo Kelly. With the assistance of ARIFA, the Special Master has appointed new officers and directors of each of these entities to streamline and facilitate the monitoring of internal corporate processes. The Special Master has also updated and paid past due registration fees (*tasas únicas*) that must be periodically paid to Panamanian authorities by each of these Panamanian entities.

**g. Additional Assets**

***(1) The Mexican Hotel Properties***

Based on an FTI valuation, the four Mexican hotels (the Avalon Grand Cancún Hotel, the Avalon Reef Club Isla Mujeres Hotel, the Avalon Baccara Hotel, and the Avalon Excalibur Acapulco Hotel) have a combined total estimated net realizable value of between USD11,900,000 and USD13,100,000.<sup>1</sup>

The Special Master and Frontera have prepared marketing materials for each hotel property and have initiated the sales strategy for the hotels. The Special Master, in consultation with the USAO, developed a plan to remove encumbrances on the hotels represented by the Universal Leases attached thereto so as to maximize the proceeds resulting from an eventual sale of the hotel properties. The Universal Leases affect the marketability of some of the hotel properties. The Special Master presented a motion before this Court to this effect on December 22, 2011.

***(2) The Palmer Johnson Yacht***

The 126-foot Palmer Johnson yacht, “Time,” is owned by Saint Etienne, Inc., a Panamanian entity. Since the filing of the Original Plan of Action with this Court, Frontera has engaged a yacht broker to sell this asset. The yacht was on the market with a listing price of USD2,250,000. As there had been no interested buyers, the Special Master lowered the sale price to USD1,900,000 on May 13, 2011. The Special Master and Frontera continue to market the yacht.

***(3) Quarry***

Grupo Kelly conveyed to the Restitution Trust a 320-hectare quarry (the “Quarry”) located within six kilometers of the Puerto Cancún Project. The Quarry has been an important supply source for the construction of Puerto Cancún, because it has provided thousands of tons of landfill that have been used to fill in the swampland on which the Puerto Cancún Project is

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<sup>1</sup> Note that Grupo Kelly estimated the value of these assets at USD44,000,000.

constructed. Approximately forty hectares of the land comprising the Quarry were originally sold to Desarrolladora Homex, S.A. de C.V. ("Homex"), a company that engages in the development of residential housing in Mexico ("Original Sale"). Since the Original Sale, Grupo Kelly and Homex have entered into a subsequent agreement pursuant to which Homex will acquire the entirety of the Quarry (except for the landfill donation described below) in exchange for the monies Homex had already deposited in connection with the purchase of an unrelated parcel in Puerto Cancún ("Homex Puerto Cancún Parcel") and USD3,000,000. Homex still owes approximately USD917,000 in connection with this transaction and the Special Master has included the parcel previously sold to Homex in the inventory of lots in Puerto Cancún to be sold to MIRA.

**(4) *Avanti***

The Special Master and Frontera distributed marketing material regarding Avanti Motor Corporation and its affiliates ("Avanti") to interested parties and received preliminary non-binding indications of interest and non-disclosure agreements for the stock owned by Avanti Automotive S.A. de C.V. and the active U.S. trademarks and design patent owned by Avanti Motor Corporation, as well as a variety of classic cars owned by the Kelly family.

The Special Master sold two 2006 Avanti convertible automobiles for USD8,000 each in December 2011 and has received interest in three to four other Avanti automobiles at that price point. There are twenty other automobiles at various levels of upkeep that the Special Master continues to market in both the Mexican and U.S. markets. The Special Master hopes to have two to four more cars in the U.S. by February 2012, depending on each car's documentation status and available paperwork.

The Special Master received a very low bid for the active U.S. trademarks and the design patent owned by Avanti, but rejected this bid as unreasonable. The Special Master and Frontera continue to market the active U.S. trademarks and the design patent.

**(5) *Odyssey Health Club***

The Odyssey Health Club was listed for sale with Colliers International, a commercial real estate broker, on January 26, 2010 for USD2,900,000. The Odyssey Health Club consists of two properties on the coastline ten minutes north of downtown Cancun. One property holds a building where the Health Club's main operations were located, and includes a pool, tennis courts, and basketball courts. The other property is located across the street on the beach and was used as a beach club for the members. The Odyssey Health Club has been non-operational for several years.

The property has received some interest over the last few months, including offers that the Special Master and Frontera did not seriously entertain because they were well outside the set sales parameters in price and terms. The Special Master and the broker continue to market the property.

**(6) Grupo Kelly Corporate Building**

The Grupo Kelly corporate building, located at Av Coba #82 Int 301 Sm3 Mza10 in Cancun, was listed for sale with Coldwell Banker on October 28, 2010 for USD1,550,000. In order to improve the likelihood of a quick sale of the property, the Special Master requested that Grupo Kelly vacate the building and move their corporate offices to empty commercial space within the Avalon Grand Cancun Hotel. As a result, Grupo Kelly has vacated the building.

The building has received one offer that the Special Master and Frontera are currently considering despite it being below the set sales parameters in terms of price. The Special Master hopes to bring an offer on the corporate building to the Court for approval by February 2012.

**(7) Kelly Family Homes**

The Kelly family owns five homes in Cancun (collectively, the "Kelly Family Homes"). The Special Master and Frontera are working with Michael P. Kelly, his attorneys, and Costa Realty to evaluate the Kelly Family Homes for sale. The Special Master has received one bid for one of the homes ("Anessa's House") and expects to receive more once the homes are on the market.

This bid for Anessa's House was accepted by the Special Master on December 21, 2011, and notice of the accepted bid was published in a paper of local circulation in Cancun from December 24, 2011 to January 4, 2012. Having received no topping bids, the Special Master will move to close on the sale of Anessa's House in January 2012.

**(8) Donzi boats**

There are two Donzi speedboats – a 1999 Donzi 33ZX2 MerCruiser owned by Donald L. Kelly and a 2001 Donzi 28ZXO2 MerCruiser owned by Michael P. Kelly (the "Donzis").

The Special Master is currently marketing the Donzis in Mexico and working to finalize the import paperwork to bring the Donzis to the improved market opportunities in the U.S.

**(9) Isla Mujeres Lot**

Grupo Kelly, through Senza Dubbio Bella, S.A. de C.V., owns an undeveloped, vacant beach front lot on Isla Mujeres with a surface area of approximately 5,150 square meters. This lot was contributed as part of the "Exhibit B" assets identified in the Special Master's Original Plan of Action. It was listed with a commercial real estate broker, Coldwell Banker, on January 30, 2010 and was actively marketed at USD1,250,000. There was little interest in the lot at that list price due to the fact that the lot has environmentally sensitive mangrove growth on it. Additionally, there is a neighboring turtle farm that has expanded on to part of the beach front of this lot. These two factors considerably reduce the developable area of the lot. A subsequent appraisal of the Isla Mujeres lot in August 2011 valued it at MXN8,991,000 or USD737,000.

On August 12, 2011, a prospective buyer agreed to buy the Isla Mujeres lot for USD500,000. The Special Master published the proposed sale terms in *Novedades*, a newspaper of general circulation in Cancun, Mexico, for the 10-day publication period required under the

Proposed Sale Procedure for Real Property of the Special Master.<sup>2</sup> No higher bids for the property were received. The Court approved the sale on October 24, 2011.

Upon further due diligence, the prospective buyer of the Isla Mujeres lot found that Grupo Kelly, through Senza Dubbio Bella, S.A. de C.V., does not own the federal maritime terrestrial zone (ZOFEMAT) concession allowing access to and development along the beach adjacent to the Isla Mujeres lot. In addition, the potential buyer alleges that the Isla Mujeres lot is currently subject to litigation between the Federal Ministry of Environment and Natural Resources (“SEMARNAT”) and the local municipality. The Special Master has not yet confirmed the existence of such litigation, but according to the prospective buyer, SEMARNAT alleges that the Isla Mujeres lot is a part of the federal costal wetlands and therefore cannot be owned by a private party.

As a result of these discoveries, the prospective buyer has requested a significant discount from the USD500,000 offer presented on August 12, 2011. The Special Master is currently working with Mexican counsel and the prospective buyer to confirm the existence of the litigation and to negotiate a revised agreement for the sale of the Isla Mujeres lot. Any subsequent deal involving a reduction in the purchase would again be subject to a publication period and the Special Master would have an opportunity to accept a higher competing bid. If a new deal is reached, the Special Master will submit a motion requesting the Court’s approval of the deal.

### **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 Grupo Kelly was consistent with the information provided by the victims.

#### **B. The Victim Claim Process: Salient Points**

The Special Master and the Special Master’s Claim Processing Agent (“Stenger”), in consultation with the USAO, drafted a proposed Amended Claims Procedure Order (the “Amended Claims Procedure Order”), which was approved by this Court on June 14, 2010. The Amended Claims Procedure Order gave the Special Master and Stenger 60 days from the date the Claims Procedure Order became effective to send each victim a Victim Claim Form with the total restitution amount that each victim is entitled to receive should the Special Master be able to make full restitution to all victims (the “Total Restitution Amount”),<sup>3</sup> as well as an explanation

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<sup>2</sup> The Court approved the Proposed Sale Procedure for Real Property of the Special Master on October 28, 2009.

<sup>3</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

of how the Special Master and Stenger reached that value. Stenger sent 8,113 claim forms to the victims on June 24 and June 25, 2010. Since then, Stenger has sent an additional 5,194 claim forms per request, upon the discovery of a new address for a victim, upon the discovery of a victim to whom a claim form had not previously been sent, or upon the linking or unlinking of leases through the course of claims processing. Thus, as of January 9, 2012, Stenger has sent a total of 13,307 claim forms.<sup>4</sup>

The Amended Claims Procedure Order required each victim to review their Claim Form and either approve the calculated Total Restitution Amount or ask for a recalculation of the Total Restitution Amount. The Victim Claim Form also asks 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 in order 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.)

In an effort to clarify questions raised by victims with regard to both the waiver language included with the Victim Claim Form and the deadline for submission of the Victim Claim Form as outlined in the Amended Claims Procedure Order, the Special Master submitted a proposed Superseding Claims Procedure Order (the “Superseding Claims Procedure Order”) to the Court, which was approved on July 28, 2010. The Superseding Claims Procedure Order made three clarifications. First, it made clear that the Claims Bar Date referred to in the Amended Claims Procedure Order was the actual deadline to challenge the Total Restitution Amount rather than a bar to receiving restitution generally. Second, the Superseding Claims Procedure Order approved the sending of a Substitute Waiver/Release (the “Substitute Waiver”) to make it clear that the waiver applied only to certain Assets (as defined in the Amended Claims Procedure Order) that currently are or may come under the control of the Court through the Special Master, and any other assets of the Defendant are subject to legal actions and other legal rights of any victim. Finally, the Substitute Waiver did not apply to any claims that victims may have against Michael E. Kelly or any agent, servant, or co-conspirator of Michael E. Kelly.

In accordance with the Superseding Claims Procedure Order, a Substitute Waiver form was sent to all identified victims on August 13, 2010, which included a clarifying letter that outlined these changes and highlighted the fact that victims were not required to sign a waiver in order to participate in the restitution program. However, the Substitute Waiver stressed the importance of the Special Master and Stenger receiving the waivers from the victims. Pursuant to advice received from both JN and ARIFA, until the victims largely have released their claims on the hotel properties, the Special Master’s ability to effectively market these properties will be compromised (due to potential purchasers’ concerns regarding the properties being free and clear of adverse claims).

In October 2010, it came to Stenger’s attention that the information provided by Grupo Kelly only included the information for the primary leaseholders and, in many cases, did not list

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will receive a pro rata share of the proceeds available for restitution, provided they have not already received distributions greater than their pro rata share.

<sup>4</sup> This figure includes duplicates as it was necessary to send some claim forms multiple times to the same victims due to failure to submit the claim forms, incorrect contact information, or errors in completion of the claim form.

the information for co-investors. While the discovery of co-investors did not affect the overall calculation of the Total Restitution Amount for each lease, the amount paid to each victim associated with such lease would differ, depending on how many co-investors there were and what percentage of the lease each co-investor owned. After consultation with the Special Master and the USAO, Stenger issued revised Victim Claim Forms to each affected victim and their co-investors.

As of January 5, 2012, Stenger had received 6,865 executed Victim Claim Forms from the victims. Of the 6,865 executed Victim Claim Forms, only 14.23% of victims disagreed with their claim as calculated by Stenger. Also, 6,811 Substitute Waivers were returned. Of those 6,811 Substitute Waivers, 86.21% agreed to waive their claims to the Assets, 12.07% did not agree, and 1.72% returned a blank form. Victims had until September 24, 2010 to contest the calculation of their Total Restitution Amount and provide supporting documentation. Co-investors who were discovered later or whose claim forms were adjusted due to the discovery of their co-investments were also given 60 days to return their Victim Claim Forms. Although the deadline for objecting to the Total Restitution Amount has now passed, Stenger is in the process of following up with those victims who have either not submitted a Victim Claim Form, have not submitted a Substitute Waiver/Release, or who failed to fully complete either document. Stenger has not been able to locate 380 victims.

The most common objection to the calculation of the Total Restitution Amount is that promised interest (or, in a few cases, promised rental payments) on the Universal Lease should be included in the Total Restitution calculation. Other objections were that (a) the initial lease investment or payments received were calculated incorrectly, or (b) restitution should be based on current fair market value of the lease, not net investment. This Court has referred all issues regarding the manner and/or process by which claims against the estate are to be valued and paid to the victim claimants to Magistrate Judge Morton Denlow. An initial status hearing to brief Judge Denlow on the matter and the victims' claims took place on August 23, 2011 and was continued to October 18, 2011. The Special Master was required to file a memorandum setting forth the outstanding legal issues and the Special Master's position with respect to those issues by October 7, 2011. However, the USAO agreed to take the lead in drafting the memorandum, and after receiving an extension, filed the memorandum on October 14, 2011. At the hearing on October 18, 2011, Magistrate Judge Denlow deferred ruling on the positions taken in the memorandum until the next hearing on December 1, 2011. The USAO filed a supplemental memorandum on November 7, 2011. Before the hearing on December 1, a number of victims submitted comments concerning the issues raised in the memoranda.

At the December 1 hearing, Magistrate Judge Denlow indicated that he agreed with the Special Master's positions, and issued a report and recommendation consistent therewith on December 21, 2011. Specifically, the report and recommendation states that: (1) the starting point for calculating restitution should be the value of the actual loss suffered by a victim, i.e. the total amount paid to obtain a Universal Lease including penalties; (2) the Special Master should have the authority to terminate or renegotiate uncompleted purchase agreements for condominiums that were to be purchased by victims in whole or in part with Rollovers (defined and discussed above); (3) pre-judgment interest should not be calculated unless and until all victims are made whole; (4) the Special Master should use his best efforts to determine each deceased victim's legal heir rather than rely on the beneficiary designations in the Universal

Leases; (5) brokers' claims should be subordinated to other victims' claims unless a broker can show that he or she used funds unrelated to Universal Lease commissions to purchase a Universal Lease; and (6) the Special Master should pay victims directly unless a victim designates otherwise.

While the liquidation of Kelly's Assets may take a considerable amount of time to complete, the Special Master does anticipate being able to make periodic restitution payments to victims on a rolling basis as substantial Assets are sold. The Special Master will decide in his discretion, with the guidance of the Court, when such distributions can be made. Distributions will be made equitably on a pro rata basis to the victims as this Court determines it is appropriate.

### **C. 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 [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 web site, [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 web site; and
- 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 to transfer control of the Assets to the Restitution Trust or otherwise take control of additional assets or the proceeds therefrom, analyze the value and sales prospects of Assets, prepare a sales strategy for the various Assets, and facilitate 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.

*[remainder of page intentionally left blank]*

**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 **11th day of January, 2012.**

DOUGLAS A. DOETSCH,  
Special Master

By: /s/ William R. Stone  
William R. Stone (ARDC No. 6300969)  
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Chicago, IL 60606  
Tel: (312) 782-0600  
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*Counsel to the Special Master*

# **EXHIBIT A**

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

Criminal Court Case No. 06 CR 964  
Reporting Period 10/1/2011 to 12/31/11

FUND ACCOUNTING (See Instructions):		Detail	Subtotal	Grand Total
Line 1	<b>Beginning Balance (As of 10/1/2011):</b>	\$7,232,798.75	\$7,232,798.75	\$7,232,798.75
	<b>Increase/ Decreases in Fund Balance:</b>			
Line 2	Business Income	-	-	-
Line 3	Cash and Securities	-	-	-
Line 4	Interest / Dividend Income/ Loss	\$786.36	\$786.36	\$786.36
Line 5	Business Asset Liquidation	\$1,116,000.00	\$1,116,000.00	\$1,116,000.00
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>\$8,349,585.11</b>	<b>\$8,349,585.11</b>	<b>\$8,349,585.11</b>
	<b>Decreases in Fund Balance:</b>			
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).....	\$467,006.61	\$467,006.61	\$467,006.61
	Independent Distribution Consultant (IDC).....	-	-	-
	Distribution Agent.....	-	-	-
	Consultants.....	\$267,250.30	\$267,250.30	\$267,250.30
	Other Legal Advisers.....	\$194,922.32	\$194,922.32	\$194,922.32
	Tax Advisers.....	\$0.00	\$0.00	\$0.00
	Claims Processing.....	\$70,953.16	\$70,953.16	\$70,953.16
	2. Administrative Expenses			
	3. Miscellaneous (Annual Account fees and Publication Fees)	\$400.00	\$400.00	\$400.00
Line 11	<b>Disbursements to Court/Other:</b>	\$0.00	\$0.00	\$0.00
Line 11a	Investment Expenses/Court Registry Investment System (CRIS) Fees	\$0.00	\$0.00	\$0.00
Line 11b	Federal Tax Payments	\$0.00	\$0.00	\$0.00
	<b>Total Disbursements to Court/Other:</b>	-	-	-
	<b>Total Funds Disbursed (Lines 9 – 11):</b>	<b>\$1,000,532.39</b>	<b>\$1,000,532.39</b>	<b>\$1,000,532.39</b>
Line 12	<b>Ending Fund Balance (As of 12/31/2011):</b>			<b>\$7,349,052.72</b>
Line 12a	Cash and Cash Equivalents			\$4,948,694.74
Line 12b	Investments			\$2,400,357.98
	<b>Additional disclosure on the Ending Fund Balance:</b>			
Line 12c	Operating Account			\$395,420.22
Line 12b	Sales Proceeds Account			\$6,953,632.50

**STANDARDIZED FUND ACCOUNTING REPORT** for Michael Kelly Restitution Fund - Cash Basis  
 Criminal Court Case No. 06 CR 964  
 Reporting Period 10/1/2011 to 12/31/11

OTHER SUPPLEMENTAL INFORMATION:		Detail	Subtotal	Grand Total
<b>Line 14</b>	<b>Report of Items NOT To Be Paid by the Fund:</b>			
<i>Line 14a</i>	<b>Disbursements for Plan Administration Expenses Not Paid by the Fund:</b>			
	<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 &amp; Bonds Not Paid by the Fund</i>	-	-	-
	<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>			
<i>Line 15a</i>	<i>Investment Expenses/CRIS Fees</i>	-	-	-
<i>Line 15b</i>	<i>Federal Tax Payments</i>	-	-	-
	<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>			
<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
<b>Line 18</b>	<b>No. of Claimants/Investors:</b>			
<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: Douglas A. Doetsch  
 (signature)  
Douglas A. Doetsch  
 (print)  
Special Master  
 (title)  
 Date: 01/10/12