

**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	)	

**TWELFTH 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 Twelfth 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 July 28, 2011 through October 23, 2011 (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 within ninety days of the Order 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.

After obtaining Court approval on November 17, 2010, the Special Master consummated the sale of The City (as defined below) on December 21, 2010 and obtained net proceeds therefrom amounting to approximately USD6,445,151. Pursuant to this Court's order of December 22, 2010, approximately USD4,000,000 of such amount was deposited into the Special Master's Sales Proceeds Account for the benefit of the victims, with the balance dedicated for deposit into the Special Master's Operating Account.

At the May 31, 2011 status hearing, the Special Master informed the Court that the Turistica Kelly sale (as defined below) had closed on May 27, 2011 and the net proceeds therefrom would total approximately USD2,539,000. The Special Master requested the Court's authorization to transfer USD600,000 of the proceeds to the Special Master's Operating Account, with the remaining balance to be deposited into the Special Master's Sales Proceeds Account for the benefit of the victims. The Court approved this request. The Special Master received USD2,549,815 on July 27, 2011 and the funds have been deposited into the appropriate accounts.

Taking into account interest accruals and disbursements to outside professionals for services rendered to the Special Master since February 10, 2009, the balance of cash and investments in the Special Master's Operating Account as of September 30, 2011 is USD295,777.96, and the balance of sale proceeds in the Special Master's Sales Proceeds Account as of September 30, 2011 is USD6,937,020.79.

## **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 derived from the disposition of such Assets from the different corporations owning such Assets 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 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. Approximately 45 potential purchasers of Puerto Cancún were identified by the Special Master and Frontera and contacted 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 of 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, and 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 "Final Sale Terms"). However, several due diligence issues remain 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 an extension until November 4, 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.

**d. Financial Monitoring Process**

Since the beginning of October 2009, Grupo Kelly has provided to 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 Cancún 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 October 2011, approximately 75%, 71%, 69%, and 53% 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 the third of the four planned condominium towers. 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 August 5, 2011, 23 deliveries have been made to condominium buyers in Towers 1 and 2 and an additional 26 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 was recently approved at the municipal level and the Special Master is awaiting confirmation from the relevant state agency. Once the condominium regime has been fully approved, the Special Master can begin issuing deeds for the property.

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

During this Reporting Period, the Special Master has worked, with the assistance of ARIFA, Panamanian counsel to the Special Master, to address marketability issues involving the Grupo Kelly corporate entities in Panama that must be resolved prior to the sale of the Avalon Grand Panama Hotel (the “Avalon Grand Panama”). In early 2011, an influential Panamanian labor union, the National Union of Tourism and Gastronomy (*Sindicato Nacional de Turismo y Gastronomía*), has made a variety of claims against the Avalon Grand Panama. The Special Master engaged labor counsel in Panama that negotiated with the union to minimize the economic impact of their demands.

The former general manager of the Avalon Grand Panama (recently deceased) represented to the Special Master that he contributed capital in an amount between

USD1,500,000 and USD2,000,000 to complete construction of the hotel. The general manager, through an entity he controlled, placed a judicial lien on the real estate comprising the hotel property. This lien must be lifted prior to selling the property. For this reason, among others, FTI Consulting, Inc. (“FTI”) determined that the Avalon Grand Panama had a total estimated net realizable value of USD0. The Office of the Special Master is currently working with the general manager’s estate to reach agreement with respect to documenting this receivable or, at a minimum, staying the judicial lien for an agreed period through a forbearance agreement.

The Special Master and Frontera currently are in discussions with several potential purchasers of the Avalon Grand Panama.

**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 are developing a sales strategy for the hotels. The Office of the Special Master, in consultation with the USAO, is also working to address the extent to which the Universal Leases affect the marketability of some of the hotel properties so as to maximize the proceeds resulting from an eventual sale of the hotel properties. The Special Master intends to bring a motion before this Court to address the universal lease issue.

***(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 currently is in negotiations to sell the yacht for a price below the current list price.

***(3) The Sabre 80 Jet Aircraft***

The Sabre 80 Jet Aircraft was the sole asset of First Sabre, S.A. de C.V., a Mexican corporation (“First Sabre”). The plane was located in a hangar in Toluca, Mexico. The condition of the plane was poor and maintenance costs were accumulating; the plane appeared to have minimal value. The Special Master entered into a Debt Acknowledgement, Payment, Offset and Release Agreement (the “Agreement”), subject to publication and final approval by

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

this Court, with the owner of the hangar in Toluca, Servicios Aéreos Jem, S.A. de C.V. (“JEMSA”) for a payment-in-kind sale of this asset. Pursuant to the terms and conditions of the Agreement: (i) First Sabre acknowledged its debt (the “Debt”) before JEMSA, *plus* any and all additional taxes for maintenance of the plane and other services rendered by JEMSA; (ii) First Sabre repaid the Debt to JEMSA in kind through the conveyance of the plane to JEMSA; (iii) since the amounts of value added tax or IVA (*Impuesto al Valor Agregado*) triggered for the services rendered by JEMSA and for the transfer of the First Sabre Plane to JEMSA were identical, the parties offset such amounts; (iv) JEMSA cancelled First Sabre’s debt with respect to maintenance fees for the plane; and (v) the parties released each other from any liability with respect to the Debt, the plane, and all services rendered by JEMSA to First Sabre.

The Special Master published the Original Sale Terms in *Novedades*, a newspaper of general circulation in Cancun, Mexico, for the 10-day publication period required under the Sale Procedures. No higher bids for the property were received. The Court heard the Special Master’s motion to approve the Agreement on July 14, 2011, but reserved final authorization until the next status hearing to give interested persons time to comment on the sale should they choose to do so. The Court entered an order approving the sale on August 2, 2011.

#### **(4) *Puerto Cancún Family Lot***

Grupo Kelly also contributed a large residential lot at Puerto Cancún (the “Puerto Cancún Family Lot”) to the Restitution Trust in July 2009. Net realizable value for this lot was not calculated by FTI. The Final Sales Terms for Puerto Cancún include the Puerto Cancún Family Lot in the real property to be conveyed.

#### **(5) *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 source of supply 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 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.

#### **(6) *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 US trademarks and design patent owned by Avanti Motor Corporation, as well as a variety of classic cars owned by the Kelly family.

One bidder has declined to continue with the bid process for the time being due to complications relating to importing the classic cars to the United States. The Special Master and Frontera are seeking the advice of an import/export advisor to resolve the situation. The first batch of cars will be imported into the United States in late October 2011.

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

***(7) 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.

***(8) 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 but the Special Master and Frontera did not seriously consider it because it was well below the set sales parameters in price. The Special Master and the broker continue to market the property.

***(9) 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 preliminary bid for one of the homes and expects to receive more once the homes are on the market. The Special Master has added an entity to the Restitution Trust so that when the Kelly Family Homes are sold, the proceeds will go into the Restitution Trust.

**(10) 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 received notice of an offer to purchase the Donzis for USD75,000 on October 4, 2011. The Special Master has published a local notice requesting superior offers for the Donzis. The Special Master and JN are preparing a Sale and Purchase Agreement.

**(11) 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 Sale Procedures. No higher bids for the property were received. The Court heard the Special Master’s motion to approve the sale on September 28, 2011, but reserved final authorization until the next status hearing scheduled for October 24, 2011 to give interested persons time to comment on the sale should they choose to do so.

### **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>2</sup> as well as an explanation 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 5,186 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 October 19, 2011, Stenger has sent a total of 13,299 claim forms.<sup>3</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).

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<sup>2</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, provided they have not already received distributions greater than their pro rata share.

<sup>3</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.

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 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 October 11, 2011, Stenger had received 6,864 executed Victim Claim Forms from the victims. Of the 6,864 executed Victim Claim Forms, only 14.23% of victims disagreed with their claim as calculated by Stenger. Also, 6,805 Substitute Waivers were returned. Of those 6,805 Substitute Waivers, 86.16% agreed to waive their claims to the Assets, 12.08% did not agree, and 1.76% 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 381 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. This will give the USAO time to file a supplemental memorandum and post the memorandum to the VNS and the victims time to comment on the positions taken in the memorandum.

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, but is hopeful that distributions will begin in late 2011. 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 **24th day of October, 2011**.

/s/ Douglas A. Doetsch  
Douglas A. Doetsch, Special Master

# **EXHIBIT A**

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

Criminal Court Case No. 06 CR 964  
Reporting Period 7/27/2011 to 9/30/2011

FUND ACCOUNTING (See Instructions):		Detail	Subtotal	Grand Total
Line 1	Beginning Balance (As of 7/27/2011):	\$7,803,064.85	\$7,803,064.85	\$7,803,064.85
	<b>Increase/ Decreases in Fund Balance:</b>			
Line 2	Business Income	-	-	-
Line 3	Cash and Securities	-	-	-
Line 4	Interest / Dividend Income/ Loss	\$3,581.30	\$3,581.30	\$3,581.30
Line 5	Business Asset Liquidation	\$0.00	\$0.00	\$0.00
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>\$7,806,646.15</b>	<b>\$7,806,646.15</b>	<b>\$7,806,646.15</b>
	<b>Decreases in Fund Balance:</b>			
Line 9	Disbursements to Investors	-	-	-
	<b>Total Disbursements for Receivership Operations</b>	-	-	-
Line 10	Disbursements for Distribution Expenses Paid by the Fund:	-	-	-
	1. Fees:			
	Special Master (including related U.S. legal fees and expenses).....	\$166,603.63	\$166,603.63	\$166,603.63
	Independent Distribution Consultant (IDC).....	-	-	-
	Distribution Agent.....	-	-	-
	Consultants.....	\$275,618.55	\$275,618.55	\$275,618.55
	Other Legal Advisers.....	\$100,792.33	\$100,792.33	\$100,792.33
	Tax Advisers.....	\$22,110.42	\$22,110.42	\$22,110.42
	Claims Processing.....	\$8,672.47	\$8,672.47	\$8,672.47
	2. Administrative Expenses			
	3. Miscellaneous (Annual Account fees and Publication Fees)	\$50.00	\$50.00	\$50.00
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>\$573,847.40</b>	<b>\$573,847.40</b>	<b>\$573,847.40</b>
Line 12	<b>Ending Fund Balance (As of 9/30/2011):</b>			<b>\$7,232,798.75</b>
Line 12a	Cash and Cash Equivalents			\$2,217,156.02
Line 12b	Investments			\$5,015,642.73
	<b>Additional disclosure on the Ending Fund Balance:</b>			
Line 12c	Operating Account			\$295,777.96
Line 12b	Sales Proceeds Account			\$6,937,020.79

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

Criminal Court Case No. 06 CR 964

Reporting Period 7/27/2011 to 9/30/2011

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: Douglas A. Doetsch  
 (signature)  
Douglas A. Doetsch  
 (print)  
Special Master  
 (title)  
 Date: Oct 24, 2011