

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 SIXTH 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 Sixth 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 January 9, 2010 through April 2, 2010 (the “Reporting Period”) with respect to the goals of his appointment: namely, preserving and repatriating Assets as defined in the Order potentially subject to forfeiture, administering their liquidation, and distributing restitution to the victims of the Defendant.

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

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

## II. THE ASSETS

### A. Cash

The Special Master has received a total of USD6,400,000 in cash from Grupo Kelly, which has been deposited in an account maintained by Mayer Brown (the "Special Master's Trust Account"). Moreover, on December 16, 2009, the Special Master received Court approval to consummate the sale of the Aguascalientes Property (as defined and discussed in Section B.3.a) that was contributed to the Restitution Trust on October 9, 2009. The proceeds of the first payment related to the Aguascalientes Sale received to date were deposited into the Special Master's Trust Account for the benefit of the victims. Taking into account interest accruals and disbursements to outside professionals for services rendered to the Special Master since January 8, 2010, the balance of cash and investments in the Special Master's Trust Account as of March 31, 2010 is USD3,834,391.34<sup>1</sup>.

### 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, Navarrete y Nader, S.C. ("JNN"), Mexican counsel to the Special Master, and Arias, Fabrega & Fabrega ("ARIFA"), Panamanian counsel to the Special Master, completed the formation of a trust in Mexico to hold the Assets (the "Restitution Trust"). One salient feature of the final Restitution Trust is that it contemplates the post-execution joinder of assets as necessary to make full restitution to the victims. Accordingly, on October 9, 2009, several Exhibit B Assets (as defined in the Fourth Status Report of the Special Master) were contributed to the Restitution Trust. The Special Master has been involved with discussions with the U.S. Attorney's Office ("USAO") and with Grupo Kelly to consider other assets that may be suitable for contribution to the Restitution Trust, as appropriate.

#### 2. Strategies to Minimize Corporate Expenses

To address the liquidity crisis experienced by Grupo Kelly in light of a sluggish real estate market and generally weak global economy, the Special Master has been working with Grupo Kelly and FTI Financial Consulting Inc. ("FTI") to identify ways in which corporate expenses may be minimized. In addition to generally scrutinizing expenses at the hotel level, the Special Master and FTI have proposed headcount reductions. For example, the vacation club sales office was recently closed due to consistently weak performance as evidenced by the Cash Flow Forecast (as defined below) as well as the substantial compensation of the primary employee of this arm of the Grupo Kelly enterprise. Working with JNN and FTI, the Special Master coordinated with Grupo Kelly to cease operations of the vacation club operation, thereby saving approximately \$500,000 annually based upon management's annual expense budget.

Additionally, in respect of Grupo Kelly management, the Special Master has proposed the termination of Chief Operating Officer, Tony Campanale, and he is currently negotiating the

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<sup>1</sup> Includes \$983,054.62 from the sale of the Aguascalientes property.

terms of such termination. The termination of Tony Campanale will cut approximately \$500,000 in annual expenses from the corporate expenses budget. Furthermore, in respect of the employment contracts for Gerardo Fernandez (“Fernandez”) and Rafael Lang (“Lang”), the Special Master has worked with JNN and FTI to produce revised employment contracts for these individuals that, in the case of Fernandez, compensate him at \$85,000 less per year. The aggregate savings resulting from these headcount reductions and the closing of the vacation club operation is approximately \$1,000,000 per year. The Special Master has made a separate written submission to the Court, under seal, regarding these employment arrangements.

The Special Master, in coordination with FTI, will continue to look for cost savings opportunities from an ongoing operational perspective. The eventual sale of the group’s Assets may also provide an opportunity to further downsize the corporate infrastructure supporting the operating companies.

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

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

The Special Master, with the assistance of FTI and Del Valle Torres (“DVT”), Mexican tax counsel to the Special Master, has invested significant time analyzing the tax implications of a potential sale of the various Assets currently subject to the Restitution Trust. This analysis has involved reviewing the balance sheets and tax accounts of the various Grupo Kelly corporations and, in particular, focusing on the substantial intercompany accounts and how best address such intercompany balances in order to minimize adverse tax consequences for the disposition of Assets. The Special Master has now instructed JNN and DVT to move forward with certain corporate restructuring steps relating to certain Grupo Kelly entities (*e.g.* mergers of certain entities) that should permit the Special Master to maximize the proceeds of a particular Asset sale available to make restitution to the victims.

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

In addition to developing a final form of Promise to Purchase instrument for real property, the Special Master, with the assistance of JNN, has developed a form of Promise to Purchase Agreement to be used in a share sale scenario. These forms, in addition to introduction letters to inform the sale process and English and Spanish form Confidentiality Agreements, will be used for the duration of the Asset sale process in order to ensure consistency among sales processes and to foster efficiency.

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

FTI has been in discussions with prospective buyers for the [REDACTED]. JNN and the Special Master have coordinated the execution of the necessary powers of attorney for the ultimate signing of the purchase and sale documentation for the [REDACTED]. FTI expects to sign purchase and sale documentation for the [REDACTED] within the next month, with a definitive closing of the transaction to occur only after the prescribed publication period and this Court’s approval have been secured.

#### **d. Meetings in Mexico**

FTI and the Special Master met with Grupo Kelly in Cancún, Mexico on February 24 and 25, 2010, to review the status of the [REDACTED] and the construction at the [REDACTED]. During these meetings, the parties toured the construction site at [REDACTED] in an effort to gain further information necessary to make an ultimate decision regarding the construction of towers three and four at [REDACTED]. The economic implications of constructing three of the four towers or completing the construction of all four planned towers is currently being discussed by the Special Master and FTI, *it being understood* that both fractional interests and condominium units have been sold in the fourth tower, and if the same is not constructed, such purchasers (if they consent) must be transferred to one of the other three towers. The Special Master is also considering constructing only two towers and finishing the completed exterior structure of the third tower with uniform building materials to give the appearance of continuing construction progress without the full (and substantial) cost of completing the interior of the third tower.

With respect to [REDACTED], during these meetings FTI and the Special Master discussed the proposed [REDACTED] sales process discussions, circulating the proposed form of sales teaser, confidentiality agreement and communication to prospective buyers to the working group and providing the form legal documentation for review. Additionally, at this time, FTI and the Special Master introduced the proposed technology solution for permitting potential purchasers access to salient information in respect of the [REDACTED] project via an internal data site maintained by the Special Master. The Special Master and FTI have separately (but with the input of Grupo Kelly) discussed and assembled a list of prospective purchasers for [REDACTED], and next steps include initiating contact with these prospective purchasers within the next month.

#### **e. Financial Monitoring Process**

Since the beginning of October 2009, Grupo Kelly has published 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”). On a weekly basis, the Special Master has hosted a conference call with Grupo Kelly management and FTI to review these forecasts. The Cash Flow Model and Cash Flow Forecast have been effective in highlighting operational strengths and weaknesses within the Grupo Kelly companies and providing the Special Master with up-to-date information to make operational decisions related to the Assets. Specifically, since the last status report, decisions have been made to focus more senior management attention on the profitability of the hotel operations; to create an internal committee to manage the negotiation process with several large current and potential customers of [REDACTED] with large accounts receivables balances owing; to reduce management overhead costs; to bring in a sales manager to professionally manage the sales efforts at the [REDACTED]; and to close down the money-losing vacation club operations (*see* discussion at Section 2).

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

During this Reporting Period, the Special Master has worked, with the assistance of Arias, Fabrega & Fabrega (“ARIFA”), Panamanian counsel to the Special Master, to address two marketability issues involving the Grupo Kelly corporate entities in Panama that must be resolved prior to the sale of the [REDACTED]: (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].

With respect to the first marketability issue, under the terms of the Restitution Trust the corporate irregularities affecting the shares of the Panamanian entities subject to the Restitution Trust must be rectified by April 23, 2010. As of March 23, 2010, the Special Master entered into a settlement agreement pursuant to Panamanian law with Panamanian lawyer, Janio Lescure. Pursuant to such settlement agreement, Janio Lescure (a) agreed to provide limited legal services to the [REDACTED] (not in excess of \$4,000 per month and to be accurately documented and approved by counsel to the Special Master on a monthly basis), (b) received a \$25,000 up-front payment (to which he was entitled in light of past legal services rendered), and (c) released all future claims arising from his engagement. Additionally, upon signature of his settlement agreement, Janio Lescure provided the corporate documentation necessary to reconstruct the corporate books and records for the Panamanian entities to be subject to the Restitution Trust. ARIFA is in the process of drafting the legal documentation and coordinating the filings necessary to issue new corporate books for the Panamanian entities and the Special Master expects to deliver the same to the Trustee under the Restitution Trust within the next month. Once the Trustee has possession of such corporate books, the Special Master will effectively hold legal title to such Panamanian corporations, thus facilitating an eventual sale of the [REDACTED].

With respect to the second marketability issue, the general manager of the [REDACTED] (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), through a corporate entity that he controls, has a lien upon the [REDACTED] that effectively blocks the Special Master’s ability to sell the hotel. The USD2,000,000<sup>2</sup> debt obligation purportedly owed to the general manager has been documented in a draft contract between the general manager and Grupo Kelly. The Special Master and ARIFA are involved in negotiations with the general manager and his counsel to finalize this draft settlement agreement, and to modify the form of the lien held by the general manager in order to facilitate a sale.

Like all of the Grupo Kelly hotel operations, the [REDACTED] continues to experience cash flow issues per the financial monitoring process (*see* discussion at Section 3.e).

### **III. THE VICTIMS**

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<sup>2</sup> Note that this figure is different from that provided in the Plan of Action because the payable was initially represented as constituting approximately USD3,500,000 to USD4,000,000 versus the USD2,000,000 contemplated under the draft settlement agreement.

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

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

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

The Special Master and the Special Master's Claim Processing Agent ("Stenger"), in consultation with the USAO, have drafted a proposed Order to Establish Preliminary Procedure of Determination of Kelly Victim Claims (the "Claims Procedure Order") for approval by this Court. Once the Claims Procedure Order is entered, the Special Master and Stenger will have thirty days 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 of how the Special Master and Stenger reached that value.

Each victim will then be required 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 will also ask 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.)

As discussed between the Special Master and the USAO, there is considerable urgency to distribute Victim Claim Forms to the Victims as soon as possible. Pursuant to advice received from both JNN and ARIFA, until the Victims largely have released their claims on the hotel properties, the Special Master cannot begin to market these properties. Because the hotel properties as a group currently operate at a substantial loss (and are consequently funded by the [REDACTED]) the sooner that the hotel properties can be marketed and sold, the higher the likely restitution amount for the Victims will be.

While the liquidation of Kelly's Assts 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 at 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.

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<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 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.

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

### **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 **2nd day of April 2010**.

/s/ Douglas A. Doetsch

Douglas A. Doetsch, Special Master

**Exhibit A**

**Standardized Fund Accounting Report**



**STANDARDIZED FUND ACCOUNTING REPORT** for Michael Kelly Restitution Fund - Cash Basis  
 Criminal Court Case No. 06 CR 964  
 Reporting Period 01/08/2010 to 03/31/2010

<b>FUND ACCOUNTING (See Instructions):</b>				
		<b>Detail</b>	<b>Subtotal</b>	<b>Grand Total</b>
Line 1	<b>Beginning Balance (As of 01/08/2010):</b>	\$3,889,459.48	\$3,889,459.48	\$3,889,459.48
	<b>Increase/ Decreases in Fund Balance:</b>			
Line 2	<b>Business Income</b>	-	-	-
Line 3	<b>Cash and Securities</b>	-	-	-
Line 4	<b>Interest / Dividend Income/ Loss</b>	-	-	-
Line 5	<b>Business Asset Liquidation</b>	861.60	861.60	861.60
Line 6	<b>Personal Asset Liquidation</b>	\$675,323.42	\$675,323.42	\$675,323.42
Line 7	<b>Third-Party Litigation Income</b>	-	-	-
Line 8	<b>Miscellaneous - Other (transferred by the defendant)</b>	-	-	-
	<b>Total Funds Available (Lines 1 - 8):</b>	<b>\$4,565,644.50</b>	<b>\$4,565,644.50</b>	<b>\$4,565,644.50</b>
	<b>Decreases in Fund Balance:</b>			
Line 9	<b>Disbursements to Investors</b>	-	-	-
	<b>Total Disbursements for Recevlership 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).....	\$253,994.77	\$253,994.77	\$253,994.77
	Independent Distribution Consultant (IDC).....	-	-	-
	Distribution Agent.....	-	-	-
	Consultants.....	\$392,828.10	\$392,828.10	\$392,828.10
	Other Legal Advisers.....	\$76,665.18	\$76,665.18	\$76,665.18
	Tax Advisers.....	-	-	-
	Claims Processing.....	\$7,715.11	\$7,715.11	\$7,715.11
	2. Administrative Expenses	-	-	-
	3. Miscellaneous (wire transfer fee)	\$50.00	\$50.00	\$50.00
Line 11	<b>Disbursements to Court/Other:</b>	-	-	-
Line 11a	Investment Expenses/Court Registry Investment System (CRIS) Fees	-	-	-
Line 11b	Federal Tax Payments	-	-	-
	<b>Total Disbursements to Court/Other:</b>	-	-	-
	<b>Total Funds Disbursed (Lines 9 - 11):</b>	<b>\$731,253.16</b>	<b>\$731,253.16</b>	<b>\$731,253.16</b>
Line 12	<b>Ending Fund Balance (As of 03/31/2010):</b>			
Line 12a	Cash and Cash Equivalents			<b>\$3,834,391.34</b>
Line 12b	Investments			\$2,156,042.54
				\$1,678,348.80

NOTE

NOTE: The Interest / Dividend Income / Loss amount is calculated by difference since detailed bank statements are not available as of the date of publication of this report.

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

Special Master:

By: /s/ Douglas A. Doetsch  
(signature)

Douglas A. Doetsch  
(print)

Special Master  
(title)

Date: 4/2/10