UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. PATRICK CHURCHVILLE, CLEARPATH WEALTH MANAGEMENT, LLC, Defendants, and CLEARPATH MULTI-STRATEGY FUND I, L.P., CLEARPATH MULTI-STRATEGY FUND II, L.P., CLEARPATH MULTI-STRATEGY FUND III, L.P., HCR VALUE FUND, L.P., Relief Defendants.	)	Case No. 15-CV-00191-S-LDA

RECEIVER'S RESPONSE TO STATEMENT OF ACREWOOD ENTITIES ABOUT RECEIVER'S PETITION FOR INSTRUCTIONS REGARDING THE PROPOSED "HCR VALUE FUND, L.P. AMENDMENT NO. 1 TO THE LIMITED PARTNERSHIP AGREEMENT"

Now comes Stephen F. Del Sesto, Esq., as Receiver for Defendants Patrick Churchville and ClearPath Wealth Management, LLC and Relief Defendants ClearPath Multi-Strategy Fund I, L.P., ClearPath Multi-Strategy Fund II, L.P., and ClearPath Multi-Strategy Fund III, L.P. (collectively "Receivership Entities"), and hereby responds to the "Statement of Acrewood Entities about Receiver's Petition for Instructions Regarding the Proposed 'HCR Value Fund, L.P. Amendment No. 1 to the Limited Partnership Agreement'" ("Acrewood Entities' Statement") (Document No. 25). The Receiver responds primarily to emphasize two points raised by the Acrewood Entities' Statement: (1) The Receiver's authority to reject pre-

receivership contracts and the doctrine requiring mutuality of offsets—to the extent that they are implicated by the Proposed HCR Value Fund, L.P. Amendment No. 1 to the Limited Partnership Agreement—are based in common law and are not dependent on the U.S. Bankruptcy Code; and (2) The Acrewood Entities' request to discontinue the management fees due to the Receivership Entities is in direct conflict with the Court's July 30, 2015 Order Concerning HCR Value Fund, L.P. (Document No. 17).[1]

I. The Receiver's authority to reject pre-receivership contracts and the doctrine requiring mutuality of offsets are based in common law and not dependent on the U.S. Bankruptcy Code.

The Acrewood Entities express concern about the Receiver's reliance on bankruptcy law as the fountainhead of the Receiver's right to reject a pre-receivership contract. Specifically, the Acrewood Entities cite 11 U.S.C. § 365(a) of the U.S. Bankruptcy Code as authorizing bankruptcy trustees to reject pre-petition contracts. The Acrewood Entities argue that the Receiver may not rely on this statutory right because the equity receivership is distinct from a Chapter 11 bankruptcy. Of course, the Acrewood Entities are correct that the two proceedings are distinct; however the common law equity receiver's right to reject a pre-receivership contract predates that of the Chapter 11 trustee.

The authority of a receiver or other insolvency-style trustee to assume or reject pre-receivership contracts is not a creation of the U.S. Code, but rather a product of the common law of receivership: "In order that the receiver may be absolutely bound by a contract of the debtor, the receiver must positively indicate his intention to take over the contract." Ralph E. Clark, CLARK ON RECEIVERS, § 428(a), at p. 722 (3d ed. 1959) (*citing Menke v. Willcox*, 275 F. 57

[1] As he did throughout his September 30 Petition for Instructions Regarding the Proposed "HCR Value Fund, L.P. Amendment No. 1 to the Limited Partnership Agreement," your Receiver will refer to Acrewood Holdings, LLC, Acrewood Investment Management, L.P., Acrewood 2013, L.P., and Acrewood 2014, L.P. collectively as the "Acrewood Entities."

(S.D.N.Y. 1921)). In fact, "[t]he U.S. Court of Appeals for the Second Circuit has held that there is a presumption that the receiver will not adopt a contract." *Id*. § 428(a), at p. 723; *Samuels v. E.F. Drew & Co., Inc.*, 292 F. 734, 739 (2d Cir. 1923) ("The receiver is under no obligation to renounce an executory contract. The contract is terminated, even though the receiver never renounces. There is a presumption that the receiver will not adopt a contract.").

"Until a receiver elects to adopt affirmatively an executory or partly executory contract or lease, or until the doing of some act, which would in law be equivalent to an election, the receiver does not become bound by such a contract or lease." *Fauci v. Mulready*, 150 N.E.2d 286, 289 (Mass. 1958) (citations omitted; internal quotation marks omitted).

> A receiver may be able to determine within a short time after his appointment that his performance of obligations of the insolvent under certain of its contracts and leases would not be advantageous. Or he may be directed by the court to liquidate the assets of the insolvent and performance may be inconsistent with liquidation. Under these circumstances he may, before accepting any benefits under the contract or lease, notify the solvent party that he will not thereafter perform the obligations of the insolvent.

Ellsworth E. Clark, Henry E. Foley, & Oscar M. Shaw, *Adoption and Rejection of Contracts and Leases by Receivers*, 46 HARV. L. REV. 1111, 1112 (May 1933)). Given that 11 U.S.C. § 365(a) was enacted as part of the Bankruptcy Reform Act of 1978, the above citations make clear that the authority to reject emanates from the common law of receivership. While a Chapter 11 trustee similarly enjoys this authority; it belongs, in the first instance, to the receiver.[2]

Furthermore, the doctrine of mutuality of offsets (briefly discussed in Paragraph 22 of the Receiver's September 30th Petition for Instructions) generally provides that preliquidation debt

[2] Certainly, this Court has the authority to order the Receiver (its appointed fiduciary) to honor the terms of the May 21, 2015 pre-receivership "Agreement Regarding Continuing HCRVF Operations." The purpose of the foregoing discussion was merely intended to alert the Court to the wealth of authority granting the Receiver the power to reject such a contract absent an order to the contrary.

cannot be offset against postliquidation claims. This too is a product of the common law of receiverships:

> But the general rule in equity, as well as at law, is that the demands to be offset must be mutual, and that debts accruing in different rights cannot be offset against each other. Thus an individual claim cannot be offset against a trust fund. So where the demand of the receiver is based, not on a credit earned before the insolvency, but on a credit earned by the receiver in the management of the estate, it cannot be offset by a claim arising before the insolvency. But when there are peculiar circumstances which make it necessary, as the only way to prevent clear injustice, to allow the set-off of debts not mutual, but accruing in different rights, this may be done by courts of full equity jurisdiction.

Peurifoy v. Gamble, 142 S.E. 788, 791 (S.C. 1927) (citation omitted). "It is well to remember that the allowance of an equitable set-off is not a matter of course, even where the ordinary technical requisites are present." *Akin v. Williamson*, 35 S.W. 569, 572 (Tenn. Chanc. Ct. 1895). "A court of equity will deny its active relief where the interposition of such relief would produce an inequitable result in a particular case."[3] *Id*.

Whether this Court ultimately finds that the Proposed "HCR Value Fund, L.P. Amendment No. 1 to the Limited Partnership Agreement" (in its original form, without the Receiver's additions) offends the above principles is beyond the scope of the Receiver's duty to the Court; however it must be clarified that the principles are indeed applicable in these proceedings.

[3] Notably, the Acrewood Entities suggest that they were aware of the strong likelihood of a receivership when they negotiated and entered into the "Agreement Regarding Continuing HCRVF Operations" (and, more specifically, the indemnification provision in Section 2.1 thereof.) *See* Acrewood Entities' Statement, at 6 ("In late May, upon the filing of the complaint, it also became clear to Acrewood Holdings that Churchville's and ClearPath's assets were very likely to be the subject of a receivership order."). While inequity abounds for all those which had the misfortune of contracting with the Defendants during the subject period of time; it would seem, at least with respect to the "Agreement Regarding Continuing HCRVF Operations," that the Acrewood Entities did so with eyes open.

II. The Acrewood Entities' request to discontinue the management fees due to the Receivership Entities would conflict with this Court's July 30, 2015 Order Concerning HCR Value Fund, L.P.

The Acrewood Entities assert that "in a situation where a manager has stopped providing any management services because of a securities claim against it, the manager, in this case ClearPath, should not continue to earn a management fee." Acrewood Entities' Statement, at 11. Offsets for past expenses aside, the Court's July 30, 2015 Order Concerning HCR Value Fund, L.P. specifically stated that, while the Acrewood Entities could replace HCR Value Fund GP, LLC as the general partner of the HCR Value Fund, L.P. Series B, there could be no dissipation or diminution of the Defendants' rights to management fees.[4] Paying management fees to a no-show manager may be inequitable, but the Receiver is not collecting management fees for a no-show manager. Rather, the Receiver will collect the management fees, to which the Receivership Estate is currently entitled, in an attempt to recompense the victims of the Defendants' conduct. The Receiver will do so, subject to further order by this Court, because it is the Receiver's duty (and role) to "take such action as necessary and appropriate for the preservation of Receivership Property or to prevent the dissipation or concealment of Receivership Property." Court's July 30th Order Appointing Receiver, at 5 ¶7G (Document No. 16).

[4] Section III of the Order reads, in relevant part, as follows:

> **IT IS FURTHER ORDERED** that HCR Value Series B may continue to operate, pursuant to the terms of the "Agreement Regarding Continuing HCRVF Operations" executed May 21, 2015 by and among various HCR Value investor entities, HCR Value, HCR Value Fund GP, LLC as general partner with an entity controlled by the same entity which controls such HCR Value investor entities, and in so doing may convert any interest of a Defendant in HCR Value to a special limited partner interest, provided that: a) No financial interest of the Defendants (including but not limited to the rights to distributions or payments in respect of any capital contributions, carried interest, or management fees due to or accrued for the benefit of the Defendants) be dissipated or diminished; . . . .

Order Concerning HCR Value Fund, L.P., at 3. (Document No. 17).

Finally, while the Acrewood Entities are correct to say that there is an alignment of interests shared by the Receivership Entities and the Acrewood Entities, *see* Acrewood Entities' Statement, at 12, that alignment is only partial. Certainly, the Acrewood Entities and the Receivership Entities will be benefited by the profits earned from the HCR Value Fund, L.P. Series B. However, the respective Entities' interests are diametrically opposed with regard to the offset and management fee issues. The Court's ruling on these issues will result in hundreds of thousands of dollars being put in the pockets of the Acrewood Entities (at the expense of the Receivership Entities) or vice versa.

CONCLUSION

For the foregoing reasons, your Receiver respectfully requests instruction from this Court as to whether the Receiver is authorized to execute the Proposed HCR Value Fund, L.P. Amendment No. 1 to the Limited Partnership Agreement with such language in Paragraph 6 of the Proposed Amendment as the Court may direct, either with or without a reservation by the Court to determine the propriety and amount of the allowable offset.[5]

[5] Should the Court ultimately permit the $110,000 in costs incurred by the Acrewood Entities to be offset against the funds due to the Receivership Entities, the Receiver would recommend that the Court order the Acrewood Entities to submit billing invoices to the Court for services rendered by the law firms of Pepper Hamilton LLP (totaling $71,512.43) and Dechert LLP (totaling $19,029.30) in a form which complies with the billing instructions to which the Receiver and all retained personnel in this receivership are bound. *See* July 30th Order Appointing Receiver, at 20 ¶59 (Document No. 16). Invoices in this form will allow the Court to ensure that the offsets reflect only "reasonable out-of-pocket costs incurred by [the Acrewood Entities] in connection with the SEC Action" as contemplated under Section 2.1 of the "Agreement Regarding Continuing HCRVF Operations."

Respectfully submitted,

/s/ Stephen F. Del Sesto

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CERTIFICATE OF SERVICE

I, Stephen F. Del Sesto, hereby certify that I filed the within document on the 15th day of October, 2015, and that notices will be sent electronically to all counsel who are registered participants identified on the Mailing Information for Case No. 15-cv-00191-S-LDA.

/s/ Stephen F. Del Sesto