BOSTON NEW YORK
www.psdfirm.com

POLLACK SOLOMON DUFFY LLP
133 Federal Street . Suite 902 . Boston, MA 02110
617.439.9800
bpollack@psdfirm.com

December 29, 2014

by email

The Honorable Mary Jo White
Chair
U.S. Securities and Exchange Committee
100 F Street, NE
Washington, DC 20549

Re: **Wextrust Receivership;**
***SEC v. Byers*, 1:08-cv-07104-DC (SDNY)**

Dear Chair White:

We represent G&H Partners AG ("G&H"), a victim with some of the largest losses from the Wextrust fraud, as well as a creditor of Wextrust and an investor of record in entities subject to the Wextrust receivership that the SEC sought and obtained in the above-referenced action. Throughout the receivership action, the SEC took positions that favored professional service providers over victims without giving the victims an adequate opportunity to be heard. In a recent Opinion & Order dated December 23, 2014, the Court reaffirmed its concerns about excessive fees charged by the professional service providers that the SEC recruited into the matter without properly negotiating reasonable and fair rates. We understand that SEC staff may view receiverships as one of the ways that they can succeed when returning to private practice, but that cannot be allowed to drive important decisions that cost victims millions of dollars. Accordingly, we insist that the SEC improve its process for commencing receiverships, for identifying appropriate professionals, and for establishing reasonable and fair rates of compensation with a primary objective of protecting victims' interests.

The Wextrust receivership made multiple national front-page headlines in the National Law Journal early in the case when the SEC supported applications by Dewey & LeBoeuf (before its collapse) for reimbursement of excessive fees (*e.g.*, Qualters, "Dewey, SEC Defend Fee Application in

Federal Securities Receivership Case," The National Law Journal at 1 (12/23/08)). Those fees arose from Dewey's use of approximately 67 timekeepers in just the first 3 weeks at excessive rates. The Court has described Dewey's services as "not cost-effective, given its extraordinarily high billing rates and apparent penchant for running the meter." 12/23/14 Order at 18. Dewey's first fee application sought more than $2.5 million for significantly less than a month of what has turned into longer than a six-year receivership. The Court issued a written opinion at the time expressly finding the fees excessive and raising serious questions about the SEC's bizarre process of selecting receiver candidates while failing to negotiate reasonable rates. The ruling slashed Dewey's bills and created a "holdback" of an additional 20% for all professional service providers, which could be revisited at the end of the case as a potential success fee based on the benefits that the estate and victims ultimately enjoy. As time went on, professional service providers sought more than $20 million in fees, while victims received a tiny fraction of that. Without G&H's initial objection to fee applications, an objection that the SEC incredibly argued against, it appears likely that the excessive billing would have continued at a pace that would have prevented any recoveries for victims.

Seemingly unaffected by the prior rulings, at a recent hearing on December 18, 2014, the SEC attorney ignored the protests of numerous victims and announced that the SEC reached an agreement with several of the professional service providers, including Deloitte, Arent Fox, and Dewey's replacement counsel at the Freshfields firm. The SEC's agreement supported an award of 71% of the "holdback" to each of them. Transcript of 12/18/14 at 8. Shockingly, the SEC attorney explained that the agreement had been reached "late" the day before, without consulting any victims or their counsel, or even giving notice of the proposed resolution before the hearing began. *Id.* Based on filings, many victims may have believed that the SEC intended to fight any further payments to professional service providers given the lack of success by them. The SEC attorney confirmed at the hearing that the settlement number did *not* arise from any "exact science," nor was it tied to successful recoveries for victims. *Id.* at 9. After additional critical feedback from the Court at the hearing, the SEC attorney explained that the Wextrust case had been an "aberration" and that he would "definitely take the transcript from this hearing and send it up so that people can see your Honor's concerns." *Id.* at 28. Nevertheless, the SEC attorney still failed to appreciate and express to the Court any concern that every extra dollar awarded to professional service providers would result in another dollar lost by victims of the Wextrust fraud.

The late-announced settlement by the SEC appeared particularly misguided given that the receivership generated *the rock bottom end of the range* that

the receiver predicted in open court of 5% to 50% recoveries for victims. The receiver described that large of a spread, 5% to 50%, when he sought early on in the action *with the SEC's support* to justify Dewey's outrageous fees. By the time of the recent December 18, 2014 hearing, the victims had still received less than 2% of their losses back. Given the service providers' failure to generate anything significantly more than the bottom end of the predicted range of 5%, the SEC attorney offered no reasoned and reasonable basis for justifying a payout of 71% of the "holdback" to a list of service providers, which would correlate to 94% of total fee requests for those firms with which the SEC reached its agreement the day before the hearing. A close look at the fee applications reveals that the primary beneficiaries of the work by the applicants have been the applicants themselves. Essentially the fee applicants have finished doing to victims what the convicted principals of Wextrust started. Under the circumstances, the SEC's energy and efforts would have been more appropriately directed to seeking recoupment of excessive fees already paid than to awarding bonuses at the expense of victims.

It is difficult to imagine that, when reaching a last-minute agreement with favored service providers, the SEC re-read the December 30, 2008 Opinion by then-District Judge Denny Chin before requesting release of "holdback" funds. In the Opinion, the Court reviewed the history underlying the excessive fees that had been charged by the receiver's then-law firm in just the first few weeks of the receivership. The Court criticized the SEC's process for making receiver recommendations. Three options were provided to Judge Richard Sullivan, including a non-lawyer financial advisor out of Atlanta. The SEC's recommendation of a partner from Dewey (a firm that a recently departed General Counsel of the SEC had joined), was accompanied by a proposal that emphasized a "longstanding commitment to public service" making Dewey "prepared to make its most experienced partners in the relevant practice areas available to support the receivership, and to do so at a substantial public service discount." Opinion at 4-5. While the receiver, Timothy Coleman, reduced his rate from $850 per hour to $250 and set other "receivership services" at no more than $200 per hour, his firm's rates were disguised through a blended hourly rate cap that allowed the firm to load the matter with less experienced lawyers to ensure that no discount for legal services would be generated. *Id.* at 5-7.

In the Opinion, the Court recognized the long-standing principle that "receivers and attorneys engaged in the administration of estates in the courts of the United States … should be awarded only moderate compensation." *In re New York Investors, Inc.*, 79 F.2d 182, 185 (2d Cir. 1935). The Court made the following findings in the Opinion, which the SEC

attorney on the matter and his favored service providers simply ignored when protecting law firms rather than victims at the recent hearing:

1. "First, the hours expended are excessive."

2. "Second, the hourly rates for legal services are unreasonably high."

3. Objecting creditors identified other SEC receivership matters, ignored by Dewey and the SEC, in which firms like Kaye Scholer, LLP, charged between $135 to $200 per hour, Hogan & Hartson charged between $200 and $220 per hour for associates and $450 and $525 per hour for partners, and K&L billed associates at $200 per hour and partners at between $300 and $390 per hour.

4. "In contrast, for example, here Dewey seeks an hourly rate of $605 for three associates – who billed more than 481 hours among them," in just the first few weeks, as recent law school graduates.

5. The blended rate discount "for legal work reflects no discount at all."

6. The fees were "too high for a securities receivership case where hundreds of victims are unlikely to recover their losses."

7. The SEC and Dewey provided "no real opportunity for the Court to solicit other proposals or to consider other receivers."

8. Dewey claimed to have self-imposed a substantial discount, but "[m]ost of this reduction [was] attributable to the billing of non-legal, receiver services" at the agreed-upon rate.

9. A "twenty percent cut here" was necessary "to account both for the excessiveness in the number of hours and the hourly rates."

10. "At the conclusion of the case, Dewey may apply for payment of all or part of" the holdback, "[d]epending on the results achieved and the benefits to the receivership estate," which include, of course, benefits for the many victims of the illegal scheme that preceded the excessive billing that this Court found in the Opinion.

Opinion at 19-23.

As found by the Court, the SEC's process for identifying potential receivers skewed the Court's selection process. After the issuance of written findings against Dewey for its excessive billing practices, the receiver still posted on his website, quite out of context, a comment by Judge Chin that he had "no quarrel" with Judge Sullivan over his choice of Dewey under the circumstances because, if faced with the same three choices of potential receivers, he would have made the same choice out of the three options. In doing so, the receiver omitted from publicity the Court's criticisms about the SEC's process and the excessive and unreasonable fees and rates that ensued. The SEC did nothing to cure this misleading post or to build more transparency for investors or to provide victims with assurances that safeguards have been implemented to prevent similar procedural flaws and harm in the future.

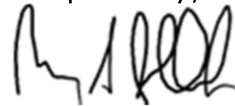
At the recent hearing, the Court criticized the SEC again for its improper selection process: "Has the SEC given further thought with respect to the appointment of counsel in this case? I mean, in retrospect, the selection of Dewey & LeBoeuf makes no sense." Transcript of 12/18/14 at 25. The SEC attorney then finally admitted that "[i]n terms of the fees and Dewey's overbilling, and whatnot, that's obviously an issue." *Id.* at 26. The Court subsequently remarked how "one of the problems was the offer of a public service discount made by Mr. [Timothy] Coleman to bill at 250 an hour was very attractive," but "when I went back and looked, I remember seeing there wasn't the same type of discount for [his] law firm." *Id.* at 27. The Court admonished the SEC attorney that "there needs to be a discussion, not just about the receiver's rate but about the lawyers rates and whether there truly is a public service discount built in right from the outset and, clearly, not just for the receiver but for counsel as well," which here was the receiver's own firm. *Id.* at 28. As the Court concluded, "[t]he situations cries out for a discussion with the SEC in advance about a budget" because early on "there was so much money [billed], and then it just set the pattern [and] I don't know if the SEC had any idea that that was going to happen." *Id.* Notwithstanding these reasons to be concerned for victims, the SEC attorney did not withdraw his offer of a last-minute agreement with all of the favored providers. Fortunately, in the December 23, Order, the Court rejected the SEC attorney's last minute compromise with Deloitte and Arent Fox, thereby returning those disputed sums to victims.

The SEC should hold accountable those staff members responsible for placing relationships with professional service providers above the protection of victims. Candidates for receiver should not be determined based on the presence of former SEC employees at their firms. Also, despite the future aspirations of SEC employees for successful private practice careers, the SEC must be willing to negotiate reasonable and fair

rates for professional service providers at meaningful public service discounts. When fee applications are submitted, the SEC should endeavor to place more emphasis on victims' interests than on professional relationships. Finally, when considering compromises with a receiver and professional service providers, the SEC should do so in a more timely and orderly manner that is transparent with victims and their representatives. Last minute settlements among a group of lawyers in a limited sub-industry of professionals are unseemly.

Accordingly, when acting as a participant in receiverships, the SEC should practice the safeguards for victims and transparency that rest at the core of its mission. Likewise, the SEC should provide more support for victims like G&H and others who seek to be heard throughout receivership actions.

Respectfully,



Barry S. Pollack