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Using a Rare Receiver Tool To Give Investors a New Hope

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The Practitioner's Corner is a regular feature where NAFER members can contribute their personal perspective on issues facing receivers.

For the nearly 400 investors of social gaming company Stocket, one day in June 2018 felt like the end of the world when the FBI raided Stocket's office and exposed a fraud scheme that had taken the investors for millions of dollars. The company's office had almost nothing left after the FBI confiscated the books, records and computers—leaving only a soon-to-be expired patent for a gaming application.

Ultimately, the U.S. Attorney's Office indicted Stocket's founder, Gerald Parker, and alleged that he operated a "boiler room" scam raising $20.5 million from investors through a network of unregistered sales agents who skimmed $10 million off the top in so-called "commissions." While the shareholders were told the investments would go towards developing and launching the company's mobile coupon app, millions of dollars according to the indictment went to pay undisclosed sales agent fees and subsidize Parker's lifestyle. The indictment also alleged that some of the money misappropriated by Parker even went to pay off his gambling debts. According to the FBI, Parker used unregistered brokers—several who have been targets of previous securities fraud actions—to cold call potential investors and sell them shares in Stocket and its predecessor Social Voucher.com Inc. Parker paid these illegal brokers between 20%

CONTINUED NEXT PAGE

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The Practitioner's Corner...*continued from page 1*

and 50% of the funds they obtained.

The investors were enticed by being a part of the booming mobile gaming industry, one of the highest performing industries globally in recent years. The industry generated $77.2 billion in the past year. Stocket was purported to be a "mobile coupon solutions provider" that allowed businesses to promote themselves directly to customers using social media. It provided consumers and gamers an innovative and unique way to shop, game and earn income all within one entertainment ecosystem by turning them into virtual store owners capable of earning real income as well as saving on real purchases.

On the day of the raid, the FBI had taken virtually everything of value in the room, leaving us, the receiver in the case and the attorney representing the defrauded investors, with few tools to recover value for the investors. We had neither funds nor financial records to go off of. Bankruptcy looked inevitable, but there was nothing to "reorganize," so it would have just shut down the company and left the shareholders with total losses. That is when we decided to engage with a core group of investors to find an alternative and creative solution.

What made this case different from other fraud schemes is the company was making progress on a legitimate product—a smartphone app that aims to combine the lucrative fields of mobile gaming, social media and online shopping. Although the FBI seized most of the company's records, we still had access to the programmers work in the cloud and the intellectual property. But we did not have the funds to keep paying the two main application developers, interim CEO Jace Simmons (who was not involved in the fundraising misconduct) and the attorneys from Greenberg Traurig, working on the patent application. Yet we knew we had to find a way to continue proceeding with the patent and the goal of ultimately selling it to recover any money for the defrauded investors. That is when we turned to a little-known receivership strategy—using a Receiver's certificate in order to raise funds.

While we both had been aware of the concept in our three decades in the field, neither of us has seen it deployed. A Receiver's certificate is a tool, a debt instrument, that allows a receiver to raise funds from existing shareholders when there are insufficient assets to carry out the duties. It is typically used in real estate receiverships in which the receiver must raise funds to complete the project. In this case, we used it in an unorthodox manner to renew the patents for the technology and keep the company operational in order to find a buyer.

Receiver's certificates are judicial creatures that typically trump all other debt, including secured debt. One of the leading cases to recognize Receiver's certificates is a 100-year-old California case—*Title Insurance and Trust Company v. California Development Company*, 171 Cal. 227 (1915). In that case, the court approved the issuance of Receiver's certificates, with priority over other debt, to care for and preserve the property during the receivership. The court noted that the decision to issue Receiver's certificates and give them priority over other debt, rests with the discretion of the court.

A big key to being able to take this approach was our active engagement with a core group of shareholders who embraced our strategy by putting up more money to salvage their original investments. We worked with them every step of the way, keeping them apprised of our actions and our end goal. We created an Advisory Board and held weekly conference calls. We arranged for them to meet prospective buyers. Building a strong relationship with them was critical as they needed to invest additional money—after already losing substantial amounts in the fraudulent scheme—for it to be successful.

The plan worked. In 2019, the state court in Palm Beach County approved the creation of the Advisory Board and the use of the Receiver's certificates. And we were ultimately able to find a buyer for the technology in TCI Entertainment ("TCI"). TCI was a fledgling company that had a corporate infrastructure and was looking for a product to back. TCI became interested in Stocket's technology because the app allows users to stock their own virtual stores with brand-name products and make real money through sales. The merger of Stocket and TCI was valued independently at $10.76 million, allowing the court to give its blessing to the sale. As part of the deal, we were able to obtain for the Stocket shareholders a majority interest in TCI Entertainment and a seat on the board of the new company—allowing them to have a future say in the company.

We are still working through the merger. Most of the TCI shares are in escrow to be redistributed to the Stocket shareholders once all of the "bad actors" are eliminated from the shareholder's roster.

This outcome is a remarkable turnaround from the shareholders' position on the day the FBI raided Stocket's office, when they feared their investment would be lost forever. Through some creative thinking and taking an out-of-the-box approach, we were able to give the shareholders a shot at seeing a return on their investment. We gave them hope.