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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

FUND.COM INC., Plaintiff, - against - ADVISORSHARES INVESTMENTS, LLC, *et al.*, Defendants.	Index No. 650321/2012 Assigned to: Singh, J. (Part 45) Mot. Seq. No. 008

REPLY MEMORANDUM OF LAW IN SUPPORT OF RECEIVER'S MOTION TO VACATE SEALING ORDER

Thomas Braziel, as receiver of Fund.com Inc., submits this reply memorandum of law in support of his motion to restore this action to the calendar and vacate the order sealing the Settlement (as defined in his opening brief).[1]

PRELIMINARY STATEMENT

AdvisorShares acknowledges that prior to the filing of the receiver's motion, it rejected proposals by receiver's counsel for achieving compliance with Delaware law, leaving the receiver with two options: (1) accept AdvisorShares' conditions for agreeing to waive confidentiality requirements (*i.e.*, consent to a delay of payments due to Fund.com under the Settlement), or (2) move to vacate the sealing order. The receiver told AdvisorShares he would move to vacate if a consensual agreement could not be reached, and did just that roughly a month after negotiations commenced.

Although vacatur is the only means by which the receiver can achieve compliance with Delaware law (without agreeing to unreasonable conditions), AdvisorShares argues such relief should be denied "in its entirety." (Garbutt Aff. ¶39.) AdvisorShares does not pretend that the stated justification for sealing set forth in the sealing order is defensible, but instead argues the parties' prior agreement to seal the Settlement constitutes good cause under 22 NYCRR § 216.1(a) and that the receiver is bound by Fund.com's prior consent to sealing. That argument fails for a number of reasons (discussed below).

[1] Under a section heading entitled "Procedural Matters," AdvisorShares questions the validity of the receiver's appointment and his counsel's standing. Such questioning is ridiculous. The Chubak Affirmation includes a court-stamped copy of the signed receivership order, which is publicly available in any event, and states in the introductory paragraph that he is counsel to "Thomas Braziel, as receiver," as does the receiver's opening brief (not Fund.com or any other entity), making any notice of appearance unnecessary.

Moreover, it would be fundamentally unfair to leave the receiver without a remedy for achieving compliance with Delaware law other than acceding to AdvisorShares' unreasonable demands. AdvisorShares suggests the receiver need not be left in the lurch as compliance could be achieved if only the receiver would agree to limit his disclosures to three items designated by AdvisorShares (payor name, payment dates, payment amounts). (Garbutt Aff. ¶¶13, 36-37.) But AdvisorShares has not actually consented to those disclosures. (*Id.* ¶39). Further, those disclosures do not enable the receiver to achieve compliance with Chancery Rule 161, which requires that the receiver provide a "full" report of company affairs to the Vice Chancellor annually, with the first report due at the end of February. In addition, it is unreasonable to allow AdvisorShares to decide how the receiver should achieve compliance with Delaware law, given that the receiver (not AdvisorShares) has a fiduciary obligation to Fund.com's stakeholders and bears responsibility for the consequences of noncompliance.[2]

ARGUMENT

I. GOOD CAUSE TO KEEP THE SETTLEMENT UNDER SEAL IS LACKING

In his opening brief, the receiver argued the sealing order should be vacated because it does not include a written finding of good cause for sealing, as required by section 216.1(a). AdvisorShares does not dispute that the stated justification for sealing—that the parties agreed to sealing pursuant to the protective order—does not qualify as good cause, but argues the decision to seal was nevertheless a valid exercise of judicial discretion given the contentious nature of the litigation, the judicially supervised settlement discussions, and the fact that confidentiality was a material component of the Settlement. (Garbutt Aff. ¶¶12-13, 16-19, 27.) However, none of these

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[2] AdvisorShares cites settlement discussions with the receiver's attorney as evidence that the relief he seeks is the "wrong remedy." (Garbutt Aff. ¶¶13, 29-30, 32; Gursky Aff. ¶¶3-4.) That evidence is inadmissible under CPLR § 4547, and should be excluded from consideration, as it is being offered by AdvisorShares for the purpose of defining the receiver's obligations under Delaware law (and not another purpose).

post-hoc justifications establish good cause as they are, in substance, an argument that the agreement of the parties qualifies as good cause and is a sufficient basis to keep a document sealed, which courts have repeatedly rejected. Moreover, none were asserted in a sealing motion or order, as required by section 216.1(a).[3]

II. THE RECEIVER DOES NOT STAND IN FUND.COM'S SHOES

AdvisorShares' argument that the receiver "is" Fund.com (Garbutt Aff. ¶¶13, 22) reflects a fundamental misunderstanding of receivership law. The receiver is an individual. Pursuant to 8 Del. C. § 291, he is responsible for "collect[ing] the outstanding debts … due and belonging to the corporation" and has the "power to prosecute and defend, in the name of the corporation or otherwise, all claims or suits ... and to do all other acts which might be done by the corporation and which may be necessary or proper." He is not the corporation.

Although a receiver effectively displaces management, he does not stand in the company's shoes as a matter of law for all purposes. Notably, courts have consistently declined to hold that a receiver steps into a company's shoes where displaced management has engaged in misconduct. The rationale for this is as follows:

> [T]he wrongdoer must not be allowed to profit from his wrong … That reason falls out now that [the wrongdoer] has been ousted from control of … the corporations. The appointment of the receiver removed the wrongdoer from the scene. The corporations were no more [the wrongdoer's] evil zombies. Freed from the spell, they became entitled to the return of the moneys—for the benefit not of [the wrongdoer] but of innocent investors …

Scholes v. Lehman, 56 F.3d 750, 754 (7th Cir. 1995) (Posner, J.), cited approvingly in *Eberhard v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008), *SEC v. Shiv*, 379 F. Supp. 2d 609, 616 (S.D.N.Y. 2005).

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[3] The receiver further disputes AdvisorShares' position that the Settlement includes commercially sensitive information (Garbutt Aff. ¶¶17, 19), but is open to discussing keeping certain exhibits under seal which AdvisorShares asserts relate to its finances/capital structure, provided the operative so ordered document and all other exhibits are unsealed.

See also FDIC v. O'Melveny & Myers, 61 F.3d 17, 18-20 (9th Cir. 1995) ("While a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on a … receiver or similar innocent that steps into the party's shoes pursuant to court order or operation of law").

That logic applies with equal force here. As this Court is aware, Jason Galanis controlled Fund.com through his indirect ownership of the company's Class B shares, and used that control to perpetrate a pump-and-dump scheme on holders of publicly traded Class A shares, which trade under the ticker symbol FNDM. Prior to this action's settlement, one of AdvisorShares' principal arguments for summary judgment was that Galanis—a securities fraud recidivist—would be the principal beneficiary of any settlement, having installed puppet directors to initiate and prosecute this action for his own benefit (Robert Levin and David Berke, respectively).

That argument was prescient. Following entry into the Settlement, Berke refused to disclose the terms of the Settlement to Class A shareholders, at Galanis's direction. Instead, at the request of Galanis's defense attorneys in the Gerova Financial Group criminal action, *USA v. Galanis*, No. 15-cr-643 (S.D.N.Y.) (in which Galanis pled guilty), Berke provided Fund.com's counsel of record with "irrevocable" payment instructions directing them to distribute the Settlement proceeds, less attorneys' fees, to himself (both individually and in the name of FNDM, LLC, an entity that Berke formed for the purpose of receiving Settlement proceeds) and to Galanis's criminal defense attorneys, in contravention of their fiduciary obligations to the company.[4] The receiver discovered this following his appointment on November 29, 2016 and

[4] If AdvisorShares was the party that demanded confidentiality (as alleged in the Garbutt Aff.), Galanis and Berke were likely thrilled to oblige so as to prevent holders of Class A shares from discovering that Galanis and Berke were going to loot Fund.com of its principal asset (Settlement proceeds), and no doubt benefited from sealing at least as much as AdvisorShares.

promptly revoked the foregoing instructions, but not before Berke paid himself over $200,000 and Galanis's criminal defense attorneys $470,000 from Settlement proceeds. Copies of documents evidencing the foregoing are attached to the accompanying Reply Affirmation.

In this manner, the receiver's appointment resulted in the displacement of wrongdoers that had controlled Fund.com before him (Galanis and Berke). Free from their control, Fund.com became a legitimate company (not Galanis' "evil zombie," in the words of Judge Posner). Accordingly, for purposes of this motion, the receiver should not be treated as standing in the shoes of the company that agreed to keep the Settlement confidential. Finally, concluding that the receiver does not stand in Fund.com's shoes for this limited purpose would afford defrauded Class A shareholders the transparency required to understand, after years of waiting, how Fund.com's assets were liquidated and distributed and make an informed judgment about the value of their shares.

III. THE SETTLEMENT DOES NOT PROHIBIT THE RECEIVER FROM SEEKING VACATUR

The Settlement's confidentiality provision (§ 35.1) does not actually prohibit parties to the Settlement from seeking vacatur of the sealing order, let alone a nonparty such as the receiver. Indeed, Section 35.1(vii) expressly contemplates disclosure of the Settlement pursuant to a court order or rule.

IV. UNSEALING THE SETTLEMENT WOULD NOT BE UNFAIR TO ADVISORSHARES

AdvisorShares argues unsealing the Settlement would be unfair, because had the Settlement not been so ordered there would be nothing to unseal. (Garbutt Aff. ¶23.) This argument reflects some serious *chutzpah* on AdvisorShares' part, as the only provision that needed judicial approval (Settlement § 11, which affects the rights of nonparties; *see also* Exhibit 1) benefits AdvisorShares, not Fund.com, suggesting judicial approval of the Settlement was sought

at AdvisorShares' request. AdvisorShares should not be allowed to request, and reap the benefits of, judicial approval of the Settlement, without bearing the risk of vacatur associated with the same.

V. THE PUBLIC HAS A PRESUMPTIVE RIGHT OF ACCESS

AdvisorShares' argument that no public interest has been alleged or shown in disclosure of the Settlement (Garbutt Aff. ¶26) is a not-so-subtle attempt to impose a burden upon the receiver where none exists. As a legal matter, the public has a presumptive right of access to all court records, which presumption is rebutted only where sealing would serve a "compelling" objective. *Applehead Pictures LLC v. Perelman*, 80 A.D.3d 181, 192 (1st Dep't 2010). Thus, the burden is on AdvisorShares to show that it has a compelling interest in keeping the Settlement under seal that outweighs the public's presumed right of access. AdvisorShares has failed to do that, and admitted its actual justification is that it paid for sealing. (Garbutt Aff. ¶¶12-13, 18, 27.) That is insufficient, particularly where, as here, the receiver is working to maximize recoveries for stakeholders upon whom Galanis perpetrated a fraud and for years have been so sorely lacking the transparency disclosure would afford them.

CONCLUSION

The receiver requests that the Court vacate the sealing order and grant such other relief as the Court deems appropriate.

Dated: January 11, 2017
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