UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. STEFAN QIN, VIRGIL TECHNOLOGIES LLC, MONTGOMERY TECHNOLOGIES LLC, VIRGIL QUANTITATIVE RESEARCH, LLC, VIRGIL CAPITAL LLC, and VQR PARTNERS LLC, Defendants.	Case No.: 20-cv-10849 (JGLC)

MEMORANDUM OF LAW IN SUPPORT OF RECEIVER'S MOTION TO ESTABLISH CLAIMS ADMINISTRATION & DETERMINATION PROCEDURES

BAKER & HOSTETLER LLP
45 Rockefeller Plaza
New York, New York 10111
Telephone: (212) 589-4200
Facsimile: (212) 589-4201

Attorneys for Receiver Robert A. Musiala, Jr.

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Robert A. Musiala Jr., as Court-appointed receiver ("Receiver") in the above-captioned action, by and through his undersigned counsel, respectfully submits this memorandum of law together with the Declaration of Jason S. Flemmons, in support of the Receiver's motion to establish claims administration and determination procedures ("Motion"). Plaintiff Securities and Exchange Commission ("SEC") has reviewed this Motion and consents to the relief requested.

I. PRELIMINARY STATEMENT

Defendant Stefan Qin fraudulently operated two Funds under his ownership and control. Virgil Sigma Fund, LP ("Sigma Fund") was a Ponzi scheme, and VQR Multistrategy Fund, LP ("VQR Fund," and together with Sigma Fund, the "Funds") was used to further that scheme. The Funds commingled assets and had no audited or verified books and records. Between June 2017 and December 2020, Qin lured over one hundred unsuspecting investors into depositing over $120 million into the Funds. Qin promised low-risk/high rewards investment, bragged publicly about the profits his Funds made when others failed, and basked in his status as a Bitcoin *wunderkind*. All of this was a lie.

None of the money deposited in Sigma Fund was deployed to the advertised cryptocurrency arbitrage trading strategies for or on behalf of Sigma Fund or its investors. Instead, much like a modern Charles Ponzi, Qin used new investor money to pay older investors, embezzled the money, and utilized Sigma Fund as a personal piggy bank, misappropriating millions of investor dollars to pay for non-Sigma Fund activities, including (a) a purported "proprietary" trading portfolio ("Prop Trading"); (b) outside investments titled in his personal name and capacity; (c) lavish living expenses; and (d) operating expenses for VQR Fund.

Despite Sigma Fund not engaging in actual trading activity, Qin manufactured account statements—including millions of dollars in fabricated profits and "performance fee rebates"—to keep Sigma Fund investors believing they were generating significant gains. In typical Ponzi fashion, to maintain the façade that Sigma Fund was legitimate and profitable, Qin used millions of dollars of new and existing Sigma Fund investor deposits to pay fictitious gains to other Sigma Fund investors. And, when the well ran dry at Sigma Fund, Qin used investor assets from VQR Fund to continue his fraudulent Ponzi scheme.

Marketed as separate entities, the Funds were inextricably financially linked such that neither could have operated without the infusion of investor dollars raised by and embezzled from the other. Each commingled assets, and misappropriated investor funds. VQR Fund investor dollars were diverted to pay Sigma Fund investor redemptions. Sigma Fund investor dollars were diverted to pay operating expenses for VQR Fund and its investment manager, Decibel18, LLC ("Decibel18"). Neither Fund was audited, resulting in internal financial records that are, at best, unreliable, and, at worst, non-existent.

Against this backdrop of deception, the Receiver must determine the legitimacy and value of claims filed against the Receivership Estate[1] ("Claims") for eventual distribution of Recoverable Assets to claimants ("Liquidation Plan"). Because of the massive fraud perpetrated by Qin, coupled with the rampant commingling in the Funds, the lack of auditing, and the limited availability of reliable internal Fund records, the Receiver has been cross-referencing documentation submitted by claimants against other records and documentation (collectively, "Estate Records"). Having conducted an initial review of Estate Records and Claims, the Receiver proposes the administrative and adjudicative procedures set forth herein, which he believes will (i) provide a fair and equitable means to determine the value of Claims; (ii) afford claimants sufficient notice of Claim determinations and a fair and equitable process by which to

[1] Capitalized terms not otherwise defined herein take the meaning afforded them in the Order Appointing Receiver, ECF No. 31 ("Receiver Order").

object to the same; and (iii) aid the Receiver in making an informed and expeditious decision as to the type and amount of future distributions as part of an overall Liquidation Plan.

For the reasons articulated above and those set forth below, the Receiver seeks an order to establish a Claims administration process that (i) approves the proposed Claims classification methodology; (ii) declares the Funds' operation a Ponzi scheme; (iii) authorizes use of the Net Investment Method for determining the value of investor Claims; and (iv) approves the proposed procedures for resolving Claim determination objections.

II. JURISDICTION

The Court has jurisdiction over these proceedings pursuant to (i) Section 22 of the Securities Act of 1933 (15 U.S.C. § 77v), and (ii) Sections 21(e) and 27 of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78u(e) and 78aa), and jurisdiction over this Motion pursuant to the Receiver Order, which empowers the Receiver to (a) develop a fair and reasonable Liquidation Plan; (b) bring legal actions necessary or appropriate to discharge his duties, (c) take such action as may be approved by this Court, and (d) take all actions to manage, maintain, and/or wind-down business operations of the Receivership Estate, including making legally required payments to creditors, employees, and agents of the Receivership Estates. Receiver Order at §§ I.7.I & K, VIII.33, and XII.44.

III. PROCEDURAL HISTORY

On December 22, 2020, the SEC commenced this action against Qin and entities he owned and controlled (ECF No. 1). On January 21, 2021, upon stipulation of the parties, (ECF No. 29), the Court entered the Receiver Order, appointing the Receiver and setting forth his mandate. On February 4, 2021, Qin pleaded guilty to one count of securities fraud in connection with his illegal Ponzi scheme. On September 15, 2021 he was sentenced to 90 months in prison.[2]

Since his appointment, the Receiver has been marshalling and preserving all Recoverable Assets for eventual distribution to defrauded investors, employees, and creditors of the Receivership Estate. On July 8, 2022, in furtherance of his duty to develop a Liquidation Plan, the Receiver filed a motion (ECF No.162), requesting the Court set a deadline for Claims submissions ("Bar Date") and approve the Receiver's proposed Claim form and notice procedures. On August 8, 2022, the Court entered an order ("Bar Date Order") (ECF No. 168) (i) establishing a Bar Date of 11:59 p.m., prevailing Eastern Time, on December 6, 2022; (ii) requiring identified stakeholders with potential claims against, or asserted equity interests in, the Receivership Estate ("Claimants") be notified of the Bar Date via email, or, if necessary, U.S. First Class Mail ("Notice"), and (iii) requiring unknown potential Claimants be notified via a five-day digital publication of a press release issued on PR Newswire ("Publication Notice").

In compliance with the Bar Date Order, the Receiver sent email Notice to all identified Claimants on August 26, 2022, and distributed the Publication Notice August 26, 2022 through August 30, 2022. Notice of the Bar Date was also posted to https://www.bakerlaw.com/qin-receivership ("Receiver's Website"). The Receiver then resent email Notice to all identified Claimants on October 26, 2022 and November 29, 2022. By this Motion, the Receiver now seeks entry of an order approving his proposed procedures for evaluating and determining Claims.

IV. FACTS

As detailed below, and in the accompanying declaration of Jason S. Flemmons, a Senior Managing Director at Ankura Consulting Group, LLC ("Flemmons Declaration" or "FD"), Qin

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[2] Plea, *U.S. v. Qin*, 21-cr-00075 (S.D.N.Y. Feb. 12, 2021), ECF No. 12; and Sentencing, *U.S. v. Qin*, 21-cr-00075 (S.D.N.Y. Sept. 29, 2021) ECF No. 36, respectively.

operated Sigma Fund as a Ponzi scheme and fraudulently operated VQR Fund in furtherance thereof, eschewing corporate formalities and commingling investor assets such that the two Funds were, for all practical purposes, a single criminal enterprise. Qin also used Sigma Fund investor funds to (a) make personal investments that were not for the benefit of Sigma Fund investors, (b) pay personal living expenses; and (c) fund the operations of VQR Fund and its investment manager, Decibel18.

A. Sigma Fund and its Predecessor Were Operated as a Ponzi Scheme and Used by Qin to Carry Out His Fraud and Misappropriate Investor Assets

Qin's web of deception began in June 2017 when he launched Virgil Capital Crypto-Fund, LP ("Virgil Crypto Fund"), the predecessor to Sigma Fund, and Virgil Capital Pty Ltd., its General Partner. FD at ¶¶17-19. Qin exercised sole control over the operations, accounts, and assets of Virgil Pty and Virgil Crypto Fund. *Id*. at ¶19. Qin marketed Virgil Crypto Fund as a "highly profitable, low-risk" investment opportunity that could "deliver returns no matter the direction of the crypto markets" through a "market-neutral algorithmic arbitrage" strategy, operating across 37+ exchanges. *Id.* at ¶20. Qin solicited investors, and by March 2018, had raised $11.8 million. *Id.* at ¶21. Instead of deploying the investor assets into the arbitrage trading strategy as promised, Qin misappropriated the money, diverting funds to accounts registered in his personal name and capacity at Bank of America, JPMorgan Chase, Commonwealth Bank of Australia ("CBA") and HSBC (collectively, "Qin Personal Accounts"), which, among other things, he used to pay for rebate and redemption payments to other Virgil Crypto Fund investors. *Id.* at ¶¶15, 21-2. To conceal his Ponzi scheme, Qin fabricated and issued monthly account statements to investors leading them to falsely believe they were earning significant profits in their accounts. *Id*. at ¶¶29-30. Nothing could have been further from the truth.

By early 2018, Qin expanded his fraudulent enterprise, from a primarily one-person operation to an operation with managerial offices in California and, later, New York known as the Virgil Sigma Fund, LP. *Id.* at ¶31. At that time, all existing Virgil Crypto Fund investors were transitioned to investors in the newly established Sigma Fund (along with the fictitious profits credited to their accounts). *Id*. at ¶33. The transition, however, was in name only. *Id*. Qin simply executed trading and agency appointment agreements between the two general partner entities—Virgil Pty and the new general partner Virgil Capital LLC—and continued to accept investor assets through Virgil Pty on Sigma Fund's behalf. *Id*. By executing paper-only transfers, Qin did not return investor money and was able to conceal the fact that the Virgil Crypto Fund did not trade or earn legitimate gains. *Id* at ¶¶33-34. Qin then continued his Ponzi scheme and illegal activities in Sigma Fund. *Id*. at ¶34.

Aside from the new name, there was little difference between Qin's promotion and management of Virgil Crypto Fund and Sigma Fund. As with the former, the latter was marketed as a low-risk/high return investment with a "consistent" upward trend in Fund performance and average monthly returns as high as 15.6%. *Id.* at ¶¶37-38. Due in large part to Qin's fraudulent representations about the nature and profitability of Sigma Fund, from February 2018 to November 2020, Qin solicited investors and raised approximately $97.4 million. *Id.* at ¶41. This money was typically deposited in various bank accounts owned and/or controlled by Qin but registered in the name of Virgil Pty, Virgil Capital, and Sigma Fund at CBA, Silvergate Bank, and Bank of America (collectively, "Sigma Deposit Accounts"). *Id.* at ¶¶13, 41.

Contrary to claims that it was engaging in "low-risk" and "market-neutral" cryptocurrency arbitrage trading and producing tremendous returns, Sigma Fund did not engage in any trading activity on behalf of its investors. *Id.* at ¶¶42-44. Its only source of revenue was the deposit of cash from its investors. *Id*. at ¶¶40-44. Bank statements for the Sigma Deposit Accounts show that any money deposited therein was either diverted to the Qin Personal Accounts, bank accounts of other entities under Qin's control, or kept in the Sigma Deposit Accounts and later redirected to other Sigma Fund investors as payment for redemptions, including fictitious profits. *Id.* at ¶46. Use of cryptocurrency exchanges would have been necessary to carry out Sigma Fund's advertised trading strategy; however, during Sigma Fund's operation, only *one* outbound transfer of investor capital to a cryptocurrency exchange occurred: $10,000 to Kraken Crypto Exchange on August 14, 2018. *Id.* at ¶43. Yet, that $10,000 was never used to conduct trading; it sat untouched in the Kraken account until the commencement of this litigation. *Id.* at ¶44.

As no trading was conducted, no performance fees could be earned by Sigma Fund. Despite this, and to conceal his fraudulent scheme, Qin continued to issue fabricated account statements showing fictitious profits purportedly earned by investors in their accounts. *Id.* at ¶¶45-48. When Sigma Fund investors sought to redeem their profits or collect "performance fee rebates," Qin paid these investors using cash invested by new or existing Sigma Fund investors. *Id.* at Section II.C.4. For example, on March 28, 2018, a Sigma Fund investor deposited $99,966.95 into a Sigma Deposit Account at CBA ending in x0146 for purported investment in the Fund. Prior to the deposit, the CBA account balance was $0. The next day, on March 29, 2018, Qin executed a wire transfer in the amount of $82,913.24 to another Sigma Fund investor for payment of a fictitious performance fee rebate. As no other money was deposited in the account prior to the withdrawal, and the deposited money wasn't withdrawn for trading purposes, the performance fee rebate was funded entirely by cash from the new Sigma Fund investor deposit. *Id.* at ¶¶51-54.

On October 29, 2019, a Sigma Fund investor deposited $1 million into a Sigma Deposit Account at Silvergate ending in x7013 ("Virgil SG x7013"). *Id.* at ¶66. Prior to this deposit, the balance in the account was $33.11. *Id.* On October 30, 2019, Qin executed three separate wire transfers in the amounts of (i) $12,560.83, (ii) $150,000, and (iii) $150,000, which were sent to three existing Sigma Fund investors to pay rebates and redemptions. *Id.* at ¶67. This left $687,472.28 in the account. *Id.* at ¶69. The next day, October 31, 2019, a second Sigma Fund investor deposited $1 million into Virgil SG x7013. *Id.* Qin then executed a wire transfer in the amount of $1,404,178.38 to yet another Sigma Fund investor to satisfy their redemption request. *Id.* As no other money was deposited in the account prior to the withdrawals and the deposited money was not withdrawn for trading purposes, the rebate and redemption payments were funded entirely with cash from newer Sigma Fund investor deposits. *Id*. at ¶70.

On October 27, 2020, just a few months before Qin's scheme was exposed, a Sigma Fund investor deposited $150,000 into Virgil SG x7013 for investment in Sigma Fund. *Id.* at ¶75. Prior to the deposit, the balance in the account was $159.39. *Id.* The next day, on October 28, 2020, Qin executed a wire transfer in the amount of $149,000 to another Sigma Fund investor to satisfy an outstanding redemption payment. *Id.* at ¶76. As no other money was deposited in the account prior to the withdrawal, and the deposited money was not withdrawn for trading purposes, the redemption was funded entirely by cash infused from the new Sigma Fund investor deposit. *Id.* at ¶77.

These are just several of the examples of Ponzi payments made throughout Sigma Fund's existence, wherein millions of dollars of newly deposited investor assets were diverted to pay fictitious gains to existing Sigma Fund investors.

1. Sigma Fund Investor Money Was Used to Fund Proprietary Trading, Make Third-Party Investments, and Pay Qin's Personal Expenses

Qin misappropriated millions in Sigma Fund investor dollars to pay for non-Sigma Fund activities, such as (a) a purported "proprietary trading" portfolio that invested in high-risk cryptocurrency strategies ("Prop Trading"); (b) third-party investments titled in Qin's personal name; and (c) lavish living expenses. *Id.* at Section II.D. The Sigma Fund investment documents did not permit Qin to use investor funds for these purposes. *Id.* at ¶37; Exhibit 29 at 7.

a. <u>$18.35 million Misappropriated to Fund Prop Trading</u>

Between February 28, 2018 and April 1, 2019, Qin misappropriated approximately $18.35 million from Sigma Fund investor deposits to finance the Prop Trading portfolio that Qin falsely led others to believe contained his personal assets to be traded for his personal benefit. *Id.* at ¶¶80-81. Proprietary trading typically occurs when an entity trades securities, commodities, or other financial instruments with its own funds rather than utilizing client (or investor) funds. *Id.* at ¶79. To execute and conceal this brazen thievery, Qin generally moved the Sigma Fund investor assets through a complicated web of accounts as follows: (1) from the Sigma Deposit Accounts to the Qin Personal Accounts; (2) from the Qin Personal Accounts to accounts in his name at various over-the-counter cryptocurrency trading desks ("OTC Desks") where the fiat currency was converted to cryptocurrency; (3) from the OTC Desks to unhosted wallets[3] that he owned and/or controlled; and finally (4) from the unhosted wallets to various accounts owned, controlled, and registered in Qin's name (and eventually subaccounts assigned to and controlled

[3] A wallet address, also known as a public key, is an alphanumeric string to and from which cryptocurrencies can be sent. Coinbase Help, *Wallet Address*, COINBASE, https://help.coinbase.com/en/coinbase/getting-started/crypto-education/glossary/wallet-address (last accessed March 23, 2024). Wallets can be hosted (custodial) or unhosted (non-custodial). An unhosted wallet is one where the funds within are controlled and custodied by the user and not a third-party intermediary. Examples include Electrum and MyEtherWallet. Conversely, a hosted wallet exists on (or is hosted by) a third-party platform, such as a verified exchange like Coinbase, Crypto.com, or Binance. *See Part 2: The Travel Rule & Hosted vs. Unhosted Crypto Wallets*, CRYSTAL INTELLIGENCE (Nov. 6, 2022), https://crystalintelligence.com/articles/part-2-the-travel-rule-hosted-vs-unhosted-crypto-wallets/. *See also* FD at ¶82, n.17.

by Prop Trading traders) on cryptocurrency exchanges where the assets were traded for Qin's personal gain and not for the benefit of Sigma Fund investors. *Id.* at Section II.D.1.

b. $15.8 million Misappropriated for Personal Third-Party Investments

Between November 2017 and July 2020, Qin siphoned approximately $15.8 million in Sigma Fund investor deposits[4] to finance more than 15 investments titled in his name and executed in his personal or individual capacity into various third-party investment vehicles—some of which were owned and operated by Sigma Fund investors. *Id.* at ¶107, Exhibit 106. To conceal and execute this theft, Qin moved investor assets from (1) the Sigma Deposit Accounts to (2) Qin Personal Accounts and then (3) wired funds directly to the various investment vehicles. *Id.* at ¶¶107-138. Six of these transfers are outlined in charts located in the Flemmons Declaration at ¶¶108, 120, and 126.

c. Sigma Fund Money Misappropriated to Pay Lavish Personal Expenses

Qin stole millions of dollars of Sigma Fund investor assets to pay for lavish personal living expenses. The Flemmons Declaration provides several examples, including the payment of (a) $175,000 to "experience" the 2019 Oscars with $12,500 tickets to an Elton John viewing party and $75,000 tickets to the Vanity Fair after-party; (b) $96,000 to buy vintage watches; and (c) approximately $250,000 in purchases related to online gaming. *Id.* at ¶¶145-162.

2. Qin's Fraud Rendered Sigma Fund Insolvent

Qin's fraudulent activities rendered Sigma Fund insolvent from inception. The deception and insolvency began with the very first investors solicited into Sigma Fund's predecessor. *Id.* at ¶164. Instead of using the deposited investor funds to conduct cryptocurrency trading, Qin misappropriated the money to pay his personal expenses. *Id.* at ¶¶21-29. In late-July 2017, the

[4] An additional $775,000 USD was diverted from Virgil Crypto Fund investors between Nov.20, 2017 and Feb. 22, 2018. *See* FD at ¶107 n.24.

first two investors in Virgil Crypto Fund (Sigma Fund's predecessor) deposited a total of AU$235,000 (then-valued at $186,200.10 USD) for purported investment in the arbitrage strategy. *Id.* at ¶24. In early August 2017, Qin diverted that money to Qin Personal Accounts, where he subsequently spent it on personal expenses, including tuition, travel, rent, and food. *Id.* at ¶¶25-28. Although Qin never traded their assets, a few weeks after accepting their investments, he disseminated falsified statements for August 2017 to the investors making it appear they had earned significant trading gains in their accounts. *Id.* at ¶29.

Due to the misappropriation of investor money, Qin created a financial hole at Sigma Fund wherein the money he promised investors as fictitious returns far exceeded the actual cash the Fund had available to pay such returns. *Id.* at ¶¶166-170. This was further exacerbated by Qin's squandering of investor funds to make personal investments, pay his living expenses, and finance Prop Trading such that Sigma Fund never had sufficient assets to repay investors the cash they had invested.

Because Sigma Fund inherited Virgil Crypto Fund's fraudulent books during the paper-only transition, Sigma Fund was insolvent from the moment it was created. *Id.* at ¶¶34, 164. As of April 1, 2018, Sigma Fund investors had deposited approximately $13.65 million for purported investment into the Fund, which included assets from Virgil Crypto Fund investors that were transferred (at least on paper) to Sigma Fund. *Id.* at ¶165. Yet, due to Qin's fraud, as of April 1, 2018, Sigma Fund only had approximately $9.5 million in the Sigma Deposit Accounts. *Id.* at ¶166. According to issued investor statements at that time, Sigma Fund and its predecessor led investors to believe that the Fund had generated significant returns totaling $18.3 million in the aggregate. *Id.* The deficit between what Qin told investors they had earned and the cash he had available to pay those earnings was almost $9 million as of the launch of the Sigma Fund in

April 2018. *Id*. Qin's failure to engage in any trading or other legitimate activity that could generate revenue, combined with his continued misappropriation of investor assets, Ponzi payments, and production of falsified investor records, created substantial liabilities for the Fund. *Id.* at ¶¶166-170. These liabilities grew exponentially worse over the next two years of the fraud as more money was raised and then stolen from investors. *Id.* By December 2020, when this litigation was commenced, Sigma Fund had less than $8,000 in the bank, yet the fabricated investor account statements issued the month prior, showed a total of almost $111 million purportedly held by investors. *Id.* at ¶169. The deficit between what Qin told investors they had earned and the cash he had available to pay was over $110 million. *Id*.

3. VQR Fund Benefitted From and Was Used to Conceal and Further the Ponzi Scheme

In early 2019, recognizing the insurmountable financial hole he had dug for himself due to his Ponzi scheme and misuse of investor funds in Sigma Fund, Qin created VQR Fund, in part, to solicit additional investor dollars and continue the concealment of his fraud. Sentencing, *U.S. v. Qin*, ECF No. 36 at 14:9-11. Although VQR did conduct trading and was marketed as a separate entity, it was financially intertwined with and co-dependent on Sigma Fund, such that both Funds relied on investor capital raised by (and embezzled from) the other. FD at ¶172. Further, there was significant overlap of the investors in the Funds, with more than half of VQR Fund's investors also invested in Sigma Fund. *Id.* at ¶229.

Sigma Fund investor assets were repeatedly diverted and used to pay VQR Fund operating expenses. *Id.* at Section III.C. Between late-February 2019 and mid-September 2020, Qin transferred over $7.2 million in stolen Sigma Fund investor dollars to Decibel18, VQR Fund's investment manager, to pay expenses, including: (a) $3.4 million for trader salaries; (b) $279,000 for legal fees; (c) $72,000 for fund administration expenses; (d) $430,000 for technology and data systems expenses; and (e) $1.5 million to cover rent and other expenses for Decibel18. *Id.* at Sections III.C.2-3. VQR Fund was not able to generate enough revenue to pay its own operating expenses, and, absent the constant flow of money from Sigma Fund investors, as described herein, would have been forced to cover such expenses with investor capital. *Id.* at ¶284. As such, VQR Fund investors benefitted greatly from the Sigma Fund Ponzi proceeds.

VQR Fund and its investors also benefitted from Qin's diversion of $18.35 million in Sigma Fund investor dollars to Prop Trading, where the misappropriated assets were put at risk and used, in part, to develop and test VQR Fund investment strategies— without risking VQR Fund investor money. *Id*. at Section III.D.

Further, the VQR Fund books and records were in such disarray that for the last six months of the Fund's operation, its administrator was unable to strike a Net Asset Value ("NAV") to determine the value of the Fund or each investor's stake therein. *Id.* at Section III.E. The limited records available demonstrate that throughout its operation, VQR Fund generated approximately $39,000 in performance fees and approximately $111,000 in profit yet incurred operating expenses of at least $4 million. *Id*. at ¶¶280-281. Therefore, without the constant infusion of Sigma Fund investor dollars, VQR Fund would have been forced to draw from its investor principal to cover operating costs and continue its operation. *Id.* at ¶284. The Receiver has not been able to reconstruct the books and records of the VQR Fund.[5]

Not only did VQR Fund benefit from the Sigma Fund Ponzi scheme, but it was also used to further the scheme. When Sigma Fund faced liquidity issues, and Qin struggled to meet investor redemption and rebate requests as they became due, he fraudulently diverted investor dollars from VQR Fund to help him make the Ponzi payments. *Id.* at Section III.B. On at least

[5] Even if the records could be reconstructed, it would be unduly burdensome and at a significant cost to the Receivership to do so.

four separate occasions throughout 2020, Qin took investor money from VQR Fund and used it to pay Sigma Fund investors. *Id.*at ¶179. To conceal the true purpose of these withdrawals from the VQR Fund administrator, these transfers were falsely referred to as loans, and the investor assets were transferred through a complex web of cryptocurrency exchange accounts, unhosted wallets, OTC cryptocurrency desks, and bank accounts. *Id.* at Section III.B.1. Each of these intricate transfers is described in detail in the Flemmons Declaration. *Id*.

First, in August 2020, Qin received a transfer of 275,000 Tether ("USDT")[6] from an unhosted wallet custodied and controlled by VQR Fund, which Qin immediately converted to cash to pay Sigma Fund investor redemptions. *Id*. at ¶¶180-208. Then, on October 8, 2020, Qin received an additional transfer of 74,997 USDT from an unhosted wallet custodied and controlled by VQR Fund, which Qin immediately converted to cash to pay Sigma Fund investor redemptions. *Id.* at ¶¶209-219. Finally, on October 14, 2020, Qin received a transfer of 149,995.5 USDT from an account at the Kraken cryptocurrency exchange registered to and operated by VQR Fund, which Qin immediately converted to cash to pay Sigma Fund investor redemptions. *Id.* at ¶¶220-228. As set forth in the Flemmons Declaration, each of the above transfers can be traced back to VQR Fund investor deposits. *Id.* at Section III.B.1.

B. Qin Admitted Fraudulently Operating Sigma Fund and Commingling Investor Assets

In parallel with the SEC's civil matter, the U.S. Department of Justice brought criminal charges against Qin, alleging, among other things, that Qin engaged in a scheme in which he embezzled assets from Sigma Fund investors to pay redemption requests to other Sigma Fund

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[6] Tether tokens (USD₮), are cryptocurrency stablecoins, whose value is pegged at 1-to-1 with a matching fiat currency and backed by Tether reserves. *See Transparency*, TETHER, https://tether.to/en/transparency/#usdt. A stablecoin is a type of cryptocurrency whose value is pegged to another asset, such as a fiat currency or gold, to maintain a stable price. *See What is a Stablecoin?*, COINBASE, https://www.coinbase.com/learn/crypto-basics/what-is-a-stablecoin.

investors. *See* Information, *U.S. v. Qin*, (S.D.N.Y. Feb. 4, 2021), ECF No. 2. The criminal information to which Qin pled guilty set forth facts, including that Qin continuously falsified Sigma Fund's performance, sent account statements to current investors reflecting significant (yet fabricated) gains, concealed Sigma Fund's true state from investors, and used newly acquired Sigma Fund investor deposits to pay older Sigma Fund investor redemptions. *See id*. at ¶¶6, 8-9, 14; and Plea, ECF No. 12 at 20:15-25. At his sentencing hearing, Qin's counsel acknowledged that Qin operated Sigma Fund as a "fraud" where he (i) took money from investors; (ii) failed to invest the money as advertised; (iii) diverted the investor assets; (iv) lied to investors about their returns; and (v) lied about where their money went. Sentencing, *U.S. v. Qin*, ECF No. 36, at 13:20-23; 14:3-4. Qin's counsel further acknowledged that "[Qin] set up VQR…to try to earn his way out of the [Sigma Fund] problem," "commingl[ed]" assets, and took "money that came from investors for the Virgil Sigma Fund…to pay for expenses for the [VQR] hedge fund." *Id*. at 14:9-11; 17:1-5; 22:1-3. Throughout the hearing, the Court repeatedly referred to Qin's actions as a "Ponzi" scheme. *Id*. at 26:15-19; 27:12-16, 21-25; and 29:7-10.

V. DISCUSSION

A. <u>The Funds Were Operated as a Ponzi Scheme</u>

As the Flemmons Declaration makes clear, Qin operated Sigma Fund as a Ponzi scheme and VQR Fund in furtherance thereof. Assets that should have been kept separate were commingled and misappropriated to conceal Qin's fraudulent scheme. Coupled with the failure to maintain any semblance of accurate or audited books and records in the Funds, this deliberate avoidance of corporate form in furtherance of Qin's fraud, erased traditional legal boundaries between the Funds and related entities such that they were effectively operating to sustain and promote the Sigma Fund Ponzi scheme. As such, the two Funds should be treated as one for purposes of valuing and determining Claims against the Receivership Estate.

A “Ponzi scheme” is an investment scam “in which earlier investors’ returns are generated by the influx of fresh capital from unwitting newcomers rather than through legitimate investment activity.” *MLSMK Inv. Co. v. JP Morgan Chase & Co.,* 651 F.3d 268, 269 n.l (2d Cir. 2011) and *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 89 (2d Cir. 2002); *see also Eberhard v. Marcu*, 530 F.3d 122, 132 n.7 (2d Cir. 2008) (defining a Ponzi scheme as one “where earlier investors are paid from the investments of more recent investors, rather than from any underlying business concern”); *Drenis v. Haligiannis,* 452 F. Supp. 2d 418, 422 (S.D.N.Y. 2006) (defining a Ponzi scheme as “a species of fraud whereby an investment fund that is unprofitable uses money from new investors to pay ‘false profits’ to old investors in order to encourage further investment and sustain the scheme”).

Courts in the Second Circuit have set forth two separate standards for determining whether a Ponzi scheme exists: (a) satisfaction of a four-factor test in which (i) deposits were made by investors; (ii) the fraudster conducted little or no legitimate business operations; and (iii) produced little or no profits; such that (iv) any payments made to investors were sourced from cash infused by after-acquired investors; or (b) identification of “badges” of fraud, the presence of one or more of which weighs in favor of finding a Ponzi scheme. *See Pergament v. Torac Realty, LLC (In re Diamond Fin. Co.)*, Ch. 7, Case No. 20-71877-reg, Adv. Proc. No. 21-08101-reg, 2024 WL 738564, at *9 (Bankr. E.D.N.Y. Feb. 22, 2024) (articulating two standards by which courts identify existence or establishment of Ponzi schemes). *See also Armstrong v. Collins,* No. 01Civ.2437(PAC), 2010 U.S. Dist. LEXIS 28075, at *69-70 (S.D.N.Y. Mar. 24, 2010) (setting forth the four factors of the Ponzi test). Under either standard, the Sigma Fund was a Ponzi scheme.

1. Sigma Fund was a Ponzi Scheme Under the Four Factor Test

Sigma Fund satisfies all four factors of the test, and the Court should find that Qin operated Sigma Fund as a Ponzi scheme. *See Moran v. Goldfarb*, 2012 WL 2930210, at *8 (S.D.N.Y. July 16, 2012) and *In re Diamond Fin. Co.*, 2024 WL 738564, at *9-11 (finding satisfaction of four-factor test established existence of Ponzi scheme). First, between February 28, 2018 and November 23, 2020, Sigma Fund investors deposited approximately $97.4 million USD for purported investment in the fund. FD at ¶41. Second, Sigma Fund did not conduct any legitimate business. Contrary to representations made in investor documents that Sigma Fund engaged in cryptocurrency arbitrage trading, Sigma Fund did not engage in any trading on behalf of its investors. *Id.* at ¶42-44. The arbitrage trading strategy Qin purported to use in Sigma Fund would have, at a minimum, required the use of exchange accounts to identify and execute on arbitrage opportunities. Yet, during the two and a half years of Sigma Fund's operations, only one single $10,000 transfer was ever made from a Sigma Deposit Account to a cryptocurrency exchange account, and that $10,000 was never even used for trading. *Id.* Instead, Qin diverted Sigma Fund investor dollars to Qin Personal Accounts where he used the money for personal gain, or he kept the assets in Sigma Deposit Accounts and used them to pay fictitious gains and rebates allegedly earned by other Sigma Fund investors. *Id.* at ¶46.

Third, as Sigma Fund did not engage in any trading or other legitimate business activity on behalf of its investors, it was unable to generate any profits or produce any legitimate gains. *Id.* at ¶47. Nonetheless, investors received monthly statements, wholly fabricated by Qin, purporting to reflect trading profits earned in their capital accounts. *Id.*; *see also* Sentencing, *U.S. v. Qin*, ECF No. 36 at 23 ("[F]or three years I . . . lied to those around me that I was achieving something, making amazing returns on their investments."). Because there is no evidence of any profitable economic activity having been undertaken by Sigma Fund, any gains that appeared in Sigma Fund investor accounts were entirely falsified.

Finally, when Sigma Fund investors sought redemptions of their capital accounts or to cash out "performance fee rebates" they were led to believe they earned, Qin paid them not with earned profits (of which there were none) but with cash contributed by newer Sigma Fund investors. FD at Section II.C.4. For example, when an existing investor believed it received its quarterly "performance fee rebate" of $82,913.24 on March 29, 2018, it instead received a portion of the $99,966.95 cash that had been newly deposited by a first-time Sigma Fund investor on March 28, 2018. *Id.* at ¶¶51-54. Similarly, on October 29 and 31, 2019, two Sigma Fund investors each deposited $1 million. *Id.* at ¶¶66, 69. Almost immediately following the new investor cash clearing the bank, Qin wired portions of it to existing Sigma Fund investors to fulfill outstanding redemption and "rebate" requests. *Id.* at ¶¶65-70. An identical transaction occurred on October 28, 2020 when an existing investor received a $149,000 redemption payment entirely funded from a new cash infusion of $150,000 deposited the day prior. *Id.* at ¶¶74-77. As the Flemmons Declaration sets forth in greater detail, Ponzi payments such as these, in which newly acquired investor deposits were diverted to satisfy existing investor redemption requests, occurred throughout Sigma Funds' existence, thereby enabling Qin to maintain the façade of a successful and lucrative investment fund and continue to defraud unwitting investors.

2. Sigma Fund was a Ponzi Scheme Under the Badges of Fraud Analysis

Applying a "badges of fraud" analysis also confirms that Sigma Fund operated as a Ponzi scheme. The presence of one or more badges of fraud demonstrates the existence of a Ponzi scheme. These badges may include, among others, (i) the absence of any legitimate business connected to the investment program; (ii) the unrealistic promises of low risk and high returns; (iii) commingling of investor money; (iv) the use of agents and brokers paid high commissions to perpetuate the scheme, (v) misuse of investor funds; (vii) the "payment" of excessively large fees to the perpetrator and (viii) the use of false financial statements. *In re Diamond Fin. Co.*, 2024 WL 738564, at *9 (citations omitted). The badges of fraud may vary among different schemes and are, "not the sole markers of a Ponzi scheme, which can be present in many forms." *Id.* First, Qin advertised Sigma Fund as low risk with a promise of average monthly returns as high as 15.6%. FD at ¶38. This was false. Second, as explained above, Sigma Fund never engaged in any legitimate business. The advertised arbitrage trading strategy was a ruse to lure investors, and there was never any trading or legitimate business activity. *Id.* at ¶¶39-44. Third, Qin stole investor funds, diverting them to Qin Personal Accounts where they were either misused for Qin's personal consumption and VQR Fund operating costs, or they were used to pay redemption and rebate payments, including fictitious profits, to other Sigma Fund investors. *Id.* at Sections II.C.4 and II.D. Fourth, despite the lack of legitimate business, Qin issued false monthly investor statements, which included fabricated returns purporting to reflect trading profits earned in investors' accounts. *Id.* at ¶¶45-48. Fifth, as Sigma Fund lacked any formal controls or third-party auditing, Qin treated all incoming investor money as his own. He commingled and moved investor funds between the Sigma Deposit Accounts and Qin Personal Accounts as well as transferred Sigma Fund investor dollars to accounts held in the name of Decibel18 for the benefit of the VQR Fund. *Id.* at ¶¶8; 14-15; and 230. Under a badges of fraud analysis, Qin operated Sigma Fund as a Ponzi scheme.

Qin also pleaded guilty to a criminal information that alleged he operated Sigma Fund as a Ponzi scheme—(i) embezzling investor capital; (ii) using the capital for purposes other than investing in the purported arbitrage strategy; (iii) lying to investors about the value, location, and status of their investment by sending account statements reflecting significant (yet fabricated) gains; and (iv) using new investor capital to pay older investor redemption requests—and in so doing violated securities laws. The case law is clear: "[b]y entering a plea of guilty, the accused is not simply stating that he did the discrete acts described in the indictment; he is admitting guilt of a substantive crime." *United States v Broce*, 488 US 563, 570 (1989). As such, by Qin's own admissions, Sigma Fund was a Ponzi scheme. *See Wiand v. Mason*, No. 8:10-CV-2146-T-17MAP, U.S. Dist. LEXIS 57904, at *9-10 (M.D. Fla. Dec. 17, 2012) ("Even if the information . . . did not specifically label the fraud a 'Ponzi scheme,' if the allegations in the information establish that the debtor ran a scheme whereby the debtor intended to defraud the debtor's creditors, evidence of a guilty verdict or plea agreement admitting the charges can establish the existence of a Ponzi scheme." (citations omitted)).

3. Sigma Fund was Insolvent from Inception

As Sigma Fund and its predecessor were Ponzi schemes from the beginning, Sigma Fund was insolvent from inception. Many courts have held that Ponzi schemes by their very nature are insolvent from the start, and the insolvency deepens as the scheme progresses. See *Cunningham v. Brown*, 265 U.S. 1, 8 (1924) (explaining that due to his fraudulent scheme, Charles Ponzi "was always insolvent, and became daily more so, the more his business succeeded."); *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006) (" a Ponzi scheme . . . is, as a matter of law, insolvent from its inception.") (citation omitted); *Scholes v. Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995) (explaining that entities run as part of Ponzi scheme "were insolvent from the outset. . ."); *Daley v. Deptula (In re Carrozzella & Richardson)*, 286 B.R. 480, 486 n. 17 (D. Conn. 2002) ("a number of courts have held that an enterprise engaged in a Ponzi scheme is insolvent from its inception and becomes increasingly insolvent as the scheme progresses.") *abrogated on other grounds by Calvert v. Brown (In re Consol. Meridian Funds)*, Case No. 10-17952, Adv. No. 12-01583, 2013 LEXIS 675 (Bankr. W.D. Wash. Feb. 19, 2013). Sigma Fund is no different. From the first investor in Virgil Crypto Fund, Qin misappropriated investor proceeds and used new investor money to pay older investors' fictitious gains. *See* Section IV.A.2, *supra.* The insolvency deepened when investors were transferred to Sigma Fund and Qin continued to raise money and misappropriate those funds in furtherance of the Ponzi scheme.

4. VQR Fund was Tainted by and a Key Player in the Operation and Funding of the Ponzi Scheme

Not only did Qin steal investor assets from both Funds, but he also commingled investor monies between and among them in such a pervasive manner that it would be impractical, if not impossible, for the Receiver to untangle the web Qin wove. FD at Sections III.B.1 and III.C. As courts have routinely observed, "due to the fungibility of money, any commingling is enough to warrant treating all the funds as tainted." *SEC v. Byers*, 637 F. Supp. 2d. 166, 177 (S.D.N.Y. 2009); *SEC v. Better Life Club of Am., Inc.*, 995 F. Supp. 167, 181 (D.D.C. 1998) ("[W]hen legitimate assets are co-mingled with illegitimate ones such that the assets cannot be separated out, a constructive trust may extend over the entire asset pool."); *SEC v. Bivona*, 2017 WL 4022485 (N.D. Cal. Sept. 13, 2017) at *9 ("[O]nce moneys are combined, disaggregation is somewhat arbitrary and disentanglement challenging. Thus, even the presence of some tainted funds in a commingled account is sufficient to taint legitimately-acquired funds."(citation omitted)).

Here, the funds in Sigma Fund and VQR Fund were tainted, with investor money raised and belonging to one Fund diverted and sent to the other. Between late 2019 and throughout 2020, over $1 million in investor assets was diverted from VQR Fund, commingled within the Sigma Deposit Accounts, and subsequently used to pay Sigma Fund investor redemptions and payments. *See* Section V.A.4, *supra*. During that same time, over $7.2 million in investor assets was diverted from Sigma Fund, commingled within Decibel18 bank accounts, and subsequently used to pay operating expenses for both VQR Fund and Decibel18—including fund administration, legal fees, trader salaries, technology systems, and rent. FD at Section III.C. As neither Fund was ever audited, the commingling remained undetected and worsened over the course of the fraud. In reality, the two Funds were financially dependent on one another such that investor Claims made against either should be treated the same.

Even though VQR Fund engaged in trading on behalf of its investors, courts have repeatedly held that the presence of some legitimate business activity will not undermine the existence of a Ponzi scheme. *See SIPC v. Bernard L. Madoff Inv. Sec. LLC*, 528 F. Supp. 3d 219, 240 (S.D.N.Y. 2021)("[T]he presence of a legitimate business alongside a Ponzi scheme does not undermine the Ponzi scheme"); *Armstrong*, 2010 U.S. Dist. LEXIS 28075, at *72 (S.D.N.Y. Mar. 24, 2010)("[A] clever twist on the Ponzi concept will not remove a fraudulent scheme from the definition of Ponzi.") (citation omitted); *see also Scholes*, 56 F.3d at 757 ("It is no answer that some or for that matter all of [the] profit may have come from legitimate trades made by the corporations. They were not legitimate. The money used. . .came from investors gulled by fraudulent representations."). The same is true here.

Qin also admitted to creating VQR Fund for the sole purpose of helping him "catch up" and "earn his way out of [the] problem" he had created at Sigma Fund. Sentencing, *U.S. v. Qin*, ECF No. 36 at 13:20-23; 14:9-11. When Qin's fraudulent activities all but drained Sigma Fund of assets, Qin used VQR Fund investor assets to provide the cash necessary to keep his Ponzi scheme afloat. FD at Section III.B.1. Throughout 2020, Qin stole approximately $1 million of VQR Fund investor assets and used them to pay Sigma Fund investor redemptions. *Id.*

Moreover, VQR Fund and its investors significantly benefitted from Qin's Ponzi scheme to the detriment of Sigma Fund investors. In marketing materials, VQR Fund claimed its trading strategies were tested "with proprietary capital of the Investment Manager" allowing the Fund to "assum[e] all the risk" prior to deploying investor capital. *Id.* at ¶277. Through this representation, VQR Fund suggested that investment in its Fund carried less risk because the trading strategies were tested and proven to generate returns. This helped VQR Fund attract investors and solicit additional capital. Missing from this narrative, however, was the fact that the purported "proprietary capital" put at risk to test VQR Fund strategies was not capital belonging to Decibel18 or Qin personally but rather capital misappropriated from Sigma Fund investors. *Id.* at ¶¶278 and Section II.D.1. It was Sigma Fund investors who bore the risk, and none of the reward, from the misappropriation of their funds.

Simply because VQR Fund conducted some legitimate business activity should not exempt it (or its investors) from being treated the same as Sigma Fund investors. Because VQR Fund operated in furtherance of, and VQR Fund investors benefitted from, Qin's Ponzi scheme, the two Funds should be treated as one for valuing and determining investor Claims.

B. Because the Funds Operated as a Ponzi Scheme, the Receiver's Proposed Claims Administration Procedures Are Fair and Equitable

In the administration and adjudication of Claims, equity receivers are guided by the principle that "equality is equity." *Cunningham*, 265 U.S. at 20. The Receiver believes that the procedures proposed herein are fair and equitable and will ensure that all Allowed Claims and Claimants will be treated fairly. Since the Funds were collectively operated as a Ponzi scheme and in furtherance of that scheme, the Net Investment Method is the most appropriate and equitable method for valuing and determining Claims of investors in the Funds. Non-investor Claimants will have their Claims determined in accordance with the proof submitted, the Estate Records, and any legal or equitable principles applicable to such Claims.

The Court has broad discretionary powers to supervise an equity receivership and establish procedures for the administration and determination of Claims, which the Second Circuit has long acknowledged. *See e.g., SEC v. Certain Unknown Purchasers of Common Stock,* 817 F.2d 1018, 1020 (2d Cir. 1987) ("[I]n shaping equity decrees, [a] trial court is vested with broad discretionary power." (quoting *Lemon v. Kurtzman*, 411 U.S. 192, 200 (1973))); *see also FDIC v. Bernstein*, 786 F. Supp. 170, 177 (E.D.N.Y. 1992) ("[A] district court has extremely broad discretion in supervising an equity receivership and in determining the appropriate procedures to be used in its administration."). Under Section 22(a) of the Securities Act and Section 27 of the Exchange Act, district courts possess "general equity powers" to remedy securities law violations. *Smith v. SEC*, 653 F.3d 121, 127 (2d Cir. 2011) (citation omitted). And where, as here, "the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy." *SEC v. Manor Nursing Ctr., Inc.*, 458 F.2d 1082, 1103 (2d Cir. 1972), *abrogated on other grounds by Liu v. SEC*., 140 S. Ct. 1936 (2020) and *SEC v. Ahmed*, 72 F.4th 379 (2d Cir. 2023); *see also Adams v. Marwil (In re Bayou Grp., LLC*), 564 F.3d 541, 548 (2d Cir. 2009). Accordingly, the Receiver submits the following procedures for approval.

1. Classification of Claims

The Receiver submits that any properly completed and timely filed Claim against the Receivership Estate should be allowed ("Allowed Claim"), subject to the calculation method(s) described herein and provided the following can be established: (i) the Claim arises out of an activity attributable to any of the Receivership Entities or the Receivership Estate; (ii) losses resulted from such activity; (iii) alleged losses are consistent with the Estate Records; and (iv) no other grounds exist for denying or subordinating the Claim.

The Receiver has conducted a preliminary review of all timely submitted Claims, which were submitted by investors (individual and institutional investors), employees, and vendors of the Receivership Estate.[7] Following this review, the Receiver has made a preliminary determination that Claims may generally fall into one of the following seven categories:

1. Investor Claims: Claims of investors who invested principal amount(s) in either (or both) of the Funds that exceeded, in aggregate, the value of any distribution(s) directly or indirectly credited to or received by the investor or for their benefit.
2. Employee Claims: Claims of former employees of Receivership Entities.
3. Administrative Claims: Claims for professional or administrative expenses incurred by the Receivership Entities during the pendency of this matter.
4. Secured Claims: Claims subject to a valid security interest in property belonging to the Receivership Estate.
5. Trade/General Unsecured Claims: Claims of trade vendors, service providers, and other general unsecured creditors.
6. Tax Claims: Claims for tax or other liabilities owed to a governmental body.
7. Denied Claims: Claims not supported by the documentation submitted therewith or by the Estate Records.

The proposed Class 1 (Investor Claims) will likely be the largest class of Claimants, with 96 Claims submitted to the Receiver totaling a collective claimed value of $252,874,486.50. Subject to the determination of this Court on the issues raised herein, the Receiver will determine the Allowed Amount for each Allowed Claim. The Allowed Amount is not indicative of the amount a Claimant will or should expect to receive through any distribution(s) of Recoverable Assets. Instead, it merely permits a Claimant holding an Allowed Claim with a positive Allowed Amount to be eligible for distribution(s) from the Receivership Estate subject to a Liquidation Plan to be decided and approved by the Court at a future date following the filing of a proposed distribution plan by the Receiver.

[7] The Receiver's review is preliminary, and no determination has been made regarding the validity of any Claim or a potential Allowed Amount. Classification of a Claim does not indicate that the Claim is allowed or otherwise valid or will be entitled to a future distribution.

2. The Net Investment Method is Proper to Value and Determine Investor Claims

As described herein, the Funds operated as a Ponzi scheme, commingled assets, and had no audited or verified books and records. *See* Section V.A, *supra*. Thus, the Receiver proposes that the fairest and most equitable means for calculating and determining Investor Claims is the Net Investment Method. Under the Net Investment Method, "a claimant's Allowed Amount is the principal balance deposited with the Receivership entities reduced by any funds the claimant has previously received, including interest, earnings, and return of principal or capital." *SEC v. Illarramendi*, No. 11cv78, U.S. Dist. LEXIS 172119, at *6-7 (D. Conn. Dec. 6, 2013).

Similarly, here, the Receiver proposes to determine an Investor Claimant's Allowed Amount by (a) taking the U.S. Dollar value of all monies – whether fiat or cryptocurrency – that a Claimant deposited in the Fund(s) (valued at the time of the deposit) and (b) reducing that value by any monies the Claimant previously received through redemptions, rebates, or withdrawals from the Fund(s). The Receiver further proposes to calculate a Claimant's net investment on a consolidated basis. This means that if a Claimant invested in both Sigma Fund and VQR Fund, any monies, including fictitious profits or rebates, withdrawn from the Claimant's account at either (or both) Fund(s) will be subtracted from the Claimant's total Allowed Amount for their Claim. For example, if an investor deposited $200,000 in Sigma Fund and received redemption payments in the amount of $250,000 and that same investor deposited $100,000 in VQR Fund but received no redemption payments, without applying the Net Investment Method (but consolidating the accounts), this investor would have a claim for $100,000 – the value lost in VQR Fund. However, under the Net Investment Method and consolidating the accounts, the investor's loss of $100,000 in VQR Fund is offset by the receipt of $50,000 in false profits from Sigma Fund, resulting in a consolidated net investment and

Allowed Amount of $50,000. Thus, the Net Investment Method yields the difference between the amount an investor deposited and the amount an investor received or withdrew from the Funds. Consolidating Claimants who had accounts in both Funds comports with the requirements of the Net Investment Method and values the Claim based on the net amount of cash the investor has actually lost. This approach is fair and equitable and properly values an investor's claim.

Courts in the Second Circuit and elsewhere have repeatedly endorsed use of the Net Investment Method as a means by which to determine a claim value in Ponzi schemes. *See e.g.*, *Byers*, 637 F. Supp. 2d at 182 (finding Net Investment Method as "most equitable" method for calculating claim value in a Ponzi scheme); *SIPC v. Bernard L. Madoff Inv. Sec. LLC (In re Bernard L. Madoff Inv. Sec. LLC)*, 424 B.R. 122, 140 (Bankr. S.D.N.Y. 2010) (finding the Net Investment Method appropriate in a Ponzi scheme "because it relies solely on unmanipulated withdrawals and deposits and refuses to permit [the perpetrator] to arbitrarily decide who wins and who loses."); *In re Bernard L. Madoff Inv. Sec. LLC,* 654 F.3d 229, 242 (2d Cir. 2011) (affirming bankruptcy court's approval of Net Investment Method for calculating investor claims in Ponzi scheme); *see also CFTC v. Barki, LLC,* No. 09-cv-106, 2009 WL 3839389, at *2-3 (W.D.N.C. Nov. 12, 2009); *SEC v. AmeriFirst Funding, Inc.*, No. 07-cv-1188, 2008 WL 919546, at *6 (N.D. Tex. Mar. 13, 2008).

The Net Investment Method has been deemed fair and just in instances, where, as here, customer returns were not generated from legitimate business activity, and the funds of the defrauded victims were commingled. *SEC v. Credit Bancorp, Ltd.*, No. 99CIV.11395, 2000 WL 152979, at *42-3 (S.D.N.Y. Nov. 29, 2000), *aff'd*, 290 F.3d 80 (2d Cir. 2002) (recognizing the Net Investment Method as a fair evaluation of claims in a Ponzi scheme so as not to support the fiction that investors received legitimate payments). In a Ponzi scheme, as fictitious gains are illegitimate, they are disregarded. Moreover, where, as here, the books and records of the Funds were fabricated, unverified, and/or unaudited, the Net Investment Method provides an equitable means of assessing a Claim's value "because it relies solely on unmanipulated withdrawals and deposits," which can be confirmed by the verifiable Estate Records primarily from banks and other financial institutions. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 238-39; *see also In re Churchill Mortg. Inv. Corp.*, 256 B.R. 664 , 682 (Bankr. S.D.N.Y. 2000) (recognizing "the universally-accepted rule that investors may retain distributions from an entity engaged in a Ponzi scheme [only] to the extent of their investments . . .").

The Net Investment Method will allow the Receiver to unwind, rather than legitimize, the fraudulent Ponzi scheme Qin perpetrated through the Funds in a manner that is fair and reasonable. The Court should approve the Receiver's request to value submitted Investor Claims based on the Net Investment Method and permit all other classifications (i.e., non-Investor Claims) to be determined based on the Receiver's review of the documentation submitted with the Claim as cross-referenced to the Estate Records.

3. The Proposed Procedures Are Fair and Equitable

The Receiver respectfully requests the Court allow him to adopt the following procedures for the determination, allowance, and objection of any Claims timely filed by a Claimant:

> 1. Step 1: Claim Determination: The Receiver will review and assess each Claim filed against the Receivership Estate to determine (a) whether such Claim meets the criteria for an Allowed Claim, and, if so, (b) the classification of the Claim and (c) the Allowed Amount (collectively, "Claim Determination").
>
> 2. Step 2: Determination Notice: By ninety (90) calendar days from the date of the Court's order approving these procedures, the Receiver will send an electronic notice to each Claimant through the Receiver's secure online claims portal (https://www.qinreceivershipclaims.com/) ("Claims Portal"),[8] which will (a) include the Claim Determination and an explanation of how it was reached; (b) provide notice that

[8] During the initial Claims process, each Claimant was required to register for and create an account in the Claims Portal for the express purpose of securely communicating with the Receiver.

the Claims Administration Order has been entered; (c) explain that if the Claimant agrees with the Claim Determination, no further action is required; (d) set forth the procedure for a Claimant to object to the Claim Determination; and (e) provide contact information for the Receiver.

3. Step 3: Objection Process:

a. Within forty-five (45) calendar days from the date on which the Determination Notice was issued to the Claimant, any Claimant that disagrees with the Claim Determination may submit to the Receiver an objection ("Objection"). All Objections must be served on the Receiver via the Claims Portal by uploading (i) a duly executed copy of the Claimant's Determination Notice along with (ii) all supporting documentation or other information that the Claimant wishes the Receiver and the Court to consider. Objections shall clearly state in writing the nature and basis of the objection and comply with all other instructions provided in the Determination Notice.

b. Should a Claimant fail to timely serve an Objection in strict compliance with subsection (a) above, then (i) the Claimant shall be deemed to have absolutely and irrevocably waived and surrendered such Objection and any future right to object to the Claim Determination; and (ii) the Claim Determination and classification shall be deemed confirmed by the Court and binding on the Claimant.

4. Step 4: Resolving Objections: Any timely Objection served on the Receiver in compliance with Section 3a, will be considered, and the Receiver will attempt to resolve such Objection directly with the Claimant through negotiation. If the parties are unable to resolve the dispute through negotiation, the Receiver will include such Objection in the Claims Schedule (defined below) as an Unresolved Objection (defined below), and the process as outlined in Step 6 shall commence.

5. Step 5: Claims Schedule: On or about thirty (30) calendar days after the last objection period has expired, the Receiver shall file a schedule with the Court ("Claims Schedule") setting forth (i) the Receiver's Claim Determinations with brief descriptions of all resolved Claims; (ii) all Objections for which settlement discussions are underway or pending; and (iii) all Objections deemed by the Receiver to require adjudication by the Court ("Unresolved Objections").

6. Step 6: Unresolved Objections: As needed, the Receiver will submit Unresolved Objections to the Court for review and final determination. The Court may, at its discretion, set a hearing for any Unresolved Objection, and the Receiver will notify the affected Claimant of such hearing. By filing a Claim and serving an Objection, the Claimant will have submitted to the exclusive jurisdiction of this Court. The objecting Claimant shall bear the burden of proof to establish the validity of their Claim in any proceeding related to an Unresolved Objection. Should a Claimant (or Claimant's counsel, if applicable) fail to appear before the Court in any Unresolved Objection proceeding, then the Objection shall be deemed forfeited, and the Claim Determination, as issued, shall be deemed confirmed by the Court and binding on the Claimant.

It is well-settled that, in a receivership case, a district court has the authority to use summary proceedings to evaluate claims and claim priority, provided the parties have an opportunity to be heard to argue their claims. *Byers*, 637 F. Supp. 2d at 184. And a summary proceeding is the preferred course of action in a federal receivership because it "reduces the time necessary to settle disputes, decreases litigation costs, and prevents further dissipation of receivership assets." *Id.* (quoting *SEC v. Elliott,* 953 F.2d 1560, 1566 (11th Cir. 1992); *see also SEC v. McGinn, Smith & Co.*, 2020 U.S. Dist. LEXIS 118746, at *4 (N.D.N.Y. July 7, 2020). ("[B]ecause the money at issue here is under the control of the receivership, and because the dispute directly implicates the disposition of receivership assets, the [C]ourt has discretion to address [it] in a summary proceeding." (citations omitted)).

Here, the proposed procedures will allow the Receiver to address disputed Claims efficiently by presenting any Unresolved Objections to the Court in an organized and consolidated manner, thereby minimizing the Court's consideration of Objections on a piecemeal basis. In a receivership, every dollar saved on litigation is a dollar that can ultimately be preserved for distribution to the estate's creditors.

The proposed Claim administration and determination procedures satisfy due process, which requires notice, an opportunity to be heard, and a fair procedure. *See Cleveland Bd. Of Educ. v. Loudermill*, 470 U.S. 532, 542 (1985); *see also SEC v. Callahan*, 193 F. Supp. 3d 177, 204-5 (E.D.N.Y. 2016) (finding due process clause requires non-party claimants be afforded notice and an opportunity to be heard before a Receiver or a Court resolves its claims); *Credit Bancorp*, 2000 WL 152979, at *35 (finding summary procedures used in a receivership satisfied due process because they afforded claimants an opportunity to be heard).

Here, each Claimant would be provided with adequate notice (45 days) and an opportunity to object to and be heard on their Claim Determination. The procedures are fair because they promote judicial efficiency and will reduce litigation costs. Accordingly, the Court should approve the Receiver's proposed Claims administration and determination procedures.

VI. CONCLUSION

For the foregoing reasons, the Receiver respectfully requests this Court enter an order (i) approving the Receiver's proposed method for classifying Claims; (ii) declaring the Funds a Ponzi scheme; (iii) approving use of the Net Investment Method for calculating and determining Investor Claims; and (iv) approving the Receiver's proposed procedures for resolving objections to Claim Determinations. To ensure all Claimants have notice of and are bound by the Court's order, the Receiver will publish a copy on the Receiver's Website.

Dated: April 8, 2024,
New York, New York

<u>/s/ Teresa Goody Guillén</u>
BAKER & HOSTETLER LLP
45 Rockefeller Plaza
New York, NY 10111-0100
Tel.: (212) 589-4200
tgoodyguillen@bakerlaw.com
Teresa Goody Guillén
Attorney for Receiver Robert A. Musiala, Jr.