

APS Client/Creditor Response to Proposed Plan of Liquidation

Name: R. Wayne Klein, as Receiver for National Note of Utah, LC, affiliated entities, and the assets of Wayne L. Palmer, appointed in *Securities and Exchange Commission v. National Note of Utah, LC et al.*, Case No. 2:12-cv-00591-BSJ (D. Utah)

Client Number: N/A

Address: c/o Peggy Hunt, Dorsey & Whitney LLP, 136 S. Main Street, Suite 1000, Salt Lake City, Utah 84101

Phone: 801.933.7360

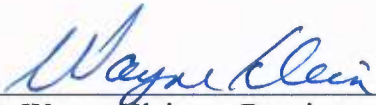
E-mail: hunt.peggy@dorsey.com

Nature of Response (you may attach additional pages)

See Exhibit A

R. Wayne, Klein as Receiver, hereby declares to the best of my knowledge and under penalty of perjury under the laws of the State of Utah and the United States of America that the foregoing and the content in the letter attached as Exhibit A is true and correct.

Dated this 20th day of October, 2014.



R. Wayne Klein, as Receiver

Please submit this objection form to Diane Thompson, Receiver of APS, c/o Mark R. Gaylord, 201 South Main Street, Suite 800, Salt Lake City, Utah 84101, no later than October 20, 2014. You may also submit this objection form via email to brownld@ballardspahr.com. Please be sure to write in the subject line of the email "Response to Plan of Liquidation." Thank you.

EXHIBIT A

PEGGY HUNT
Partner
(801) 933-8947
hunt.peggy@dorsey.com

October 20, 2014

VIA FIRST CLASS MAIL AND E-MAIL

Diane A. Thompson, Receiver
c/o Mark R. Gaylord
Ballard Spahr LLP
201 S. Main Street, Suite 800
Salt Lake City, Utah 84101
gaylord@ballardspahr.com
brownld@ballardspahr.com

Re: *Securities and Exchange Commission v. American Pension Service, Inc. et al.*,
Case No. 2:14-CV-00309-RJS-DBP (D. Utah) (the “APS Case”) - Response to
Receiver’s Proposed Plan of Liquidation

Dear Ms. Thompson:

I represent R. Wayne Klein as the duly appointed Receiver for National Note of Utah, LC and approximately 40 affiliated entities as well as the assets of Wayne L. Palmer (“NNU Receiver”) in *Securities and Exchange Commission v. National Note of Utah, LC et al.*, Case No. 12-00591 (D. Utah) (Jenkins, J.) (the “NNU Case”). Pursuant to the *Order Setting Deadlines Pertaining to Receiver’s Proposed Plan of Liquidation* entered in the APS Case, the NNU Receiver, as an interested party in the APS Case, hereby submits his comments on the *Receiver’s Proposed Plan of Liquidation* (“Plan”) for American Pension Services, Inc. and affiliated entities (collectively, “APS”).

This letter is accompanied by **Exhibits 1** through **Exhibit 14**, each of which is referenced below. I have provided two sets of these Exhibits, one set being unredacted so as to assist you with your investigation, and one set being redacted. The NNU Receiver requests that only the redacted set of Exhibits be included in any public disclosure, such as in any posting on your website or in any filing with the Court.

NNU Case Background and NNU Receiver’s Status as an Interested Party

The NNU Case is a pending civil enforcement action commenced by the Securities and Exchange Commission (the “SEC”) against National Note of Utah, LLC (“National Note”) and Wayne L. Palmer, alleging that National Note and its affiliated entities (collectively, “NNU”) were operated by Mr. Palmer as a Ponzi scheme and were engaged in various forms of securities

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fraud. Prior to the commencement of the NNU Case and the Receiver's appointment on June 25, 2012, over \$114 million was taken in by NNU from an estimated 784 investors (the "NNU Investors"). A copy of the *Order Appointing Receiver and Staying Litigation* in the NNU Case is attached as **Exhibit 1**.

NNU Investors typically invested in the enterprise by "lending" funds to National Note (the sums lent being the "Principal Investment"), and receiving promissory notes issued by National Note promising various rates of return (the "NNU Promissory Notes"). While some NNU Investors received amounts in excess of their Principal Investment prior to the commencement of the NNU Case, it is estimated that 554 received no return at all or a return that is less than their Principal Investment.

The claims process has not yet commenced in the NNU Case, but the NNU Receiver is working toward that goal. Distributions to NNU Investors holding allowed claims likely will not be made until at least 2015. It is anticipated that claims against the NNU receivership estate will be allowed only in the amount of a "Net Principal Investment," *i.e.*, the extent to which an NNU Investor has not received return of the Principal Investment. In calculating the Net Principal Investment, the Principal Investment will be reduced by all distributions made to the NNU Investor prior to the commencement of the NNU Case, including returns of principal and interest.¹ The NNU Receiver anticipates that there are at least \$59.4 million in Net Principal Investment claims, and he currently holds liquidation proceeds in the amount of \$5.9 million. Substantial assets remain to be liquidated, many subject to contested claims over interests therein, and the amount of claims made may be greater or less than what is anticipated. But, at this time, the Receiver anticipates that a return of Net Principal Investment for those NNU Investors making claims will be a small fraction of the total anticipated Net Principal Investment claims. The Receiver anticipates that the SEC will recommend and that the Court will apply a "rising tide" method of distribution on allowed Net Principal Investment claims and, therefore, as you know, even if a NNU Investor has a loss, the Investor may receive no distribution in the NNU Case if there are others who have lost more.²

Since his appointment, the NNU Receiver has obtained custody and control of NNU's business records and engaged in an extensive investigation of NNU. As part of his ongoing investigation, the NNU Receiver has identified 293 NNU Investor accounts whose NNU investments were held in APS accounts at some point before the NNU Receiver was appointed.³

¹ See Plan, Exh. A (Net Investment Method).

² See *id.* (Rising Tide Method).

³ As of August 2011, 121 of the total accounts had been inactive for 10 months or longer; 172 had activity in or after August 2011.

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The NNU Receiver believes these accounts, to the extent they were still open, were held by APS in custodial accounts as of the commencement of the APS Case (the “APS-NNU Investors”). Attached hereto as **Exhibit 2** is a list identifying the APS-NNU Investors compiled by the NNU Receiver using NNU’s records that existed as of June 25, 2012—the date of the commencement of the NNU Case. The NNU Receiver assumes for purposes of this discussion that all of these APS-NNU Investors had an account with APS as of April 25, 2014, the relevant date under the proposed Plan.⁴

NNU’s records show that as of June 25, 2012, the total “Current Note Balance” of NNU Promissory Notes held by the APS-NNU Investors’ was approximately \$16.3 million.⁵ The actual potential Net Principal Investment claims that arise from those NNU Promissory Notes is approximately \$9.3 million.⁶

While the NNU Receiver cannot represent any one of the APS-NNU Investors, and he assumes that each will review and comment, if necessary on the Plan individually, he is an interested party with standing to comment on the Plan based on his knowledge of how APS-NNU Investors will be treated in the NNU Case. Furthermore, as discussed in greater detail below, the NNU Receiver has specific information about how APS handled the accounts of APS-NNU Investors which is relevant to issues of valuation raised in the Plan.

NNU Promissory Notes Should Be Revalued

The Plan proposes that in valuing an APS client’s account, a “last statement method” of valuation will be applied—thus each APS client’s account will be valued as recorded by APS on April 25, 2014.⁷ In applying this method, the Plan states that the last statement method “removes any opportunity for manipulation of value by APS clients to limit their proportionate share of the loss and/or improve their right to distribution.”⁸ Further rationale for application of this method is that (a) submitting to a valuation process will delay administration of the case, and (b) APS clients had a duty to update their statements.⁹

⁴ See Plan, p. 21.

⁵ See Exh. 2, p. 7.

⁶ See *id.*

⁷ Plan, p. 23.

⁸ *Id.*

⁹ *Id.*

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The Plan requests authority from the Court to permit you to allocate the misappropriation loss *pro rata* to all current APS clients at a rate of 10% of the value of each relevant APS account (the “Loss Allocation”), with the Loss Allocation being based on the account’s value under the last statement method.¹⁰ As the NNU Receiver understands the Plan, each APS client will be required to pay the Loss Allocation calculated in this way to the receivership estate. After the Loss Allocation is paid, the APS client will be free to roll its account over to a new IRA or custodian.¹¹

The Plan recognizes that some APS clients may have requested that APS adjust the value of investments prior to the commencement of the APS case only to be “rebuffed” by APS.¹² In such situations, the Plan proposes “providing APS clients with the ability to provide sufficient documentation demonstrating their previous efforts to revalue their investments as well as a methodology to adjudicate those claims.”¹³

The NNU Receiver does not object to the general structure of the Plan, recognizing the monumental difficulties you likely faced in developing it, and he applauds your effort in attempting to formulate an equitable liquidation and plan of distribution. The NNU Receiver also understands that an equitable plan may require APS clients to share in the losses caused by former management’s conversion and mismanagement. The NNU Receiver is concerned, however, with the potential disparate negative impact that the Plan may have on APS-NNU Investors vis-à-vis other APS clients affected by the Plan, which based on the information herein, would be inequitable. Payment of the Loss Allocation by APS-NNU Investors is concerning because under a rising tide plan anticipated to be used in the NNU Case, many APS-NNU Investors will receive no distribution, even if they lost a good portion of their Principal Investment. If there is no distribution made for losses in the NNU Case and they are forced to pay the Loss Allocation, they will be suffering losses as a result of fraud far greater than other APS clients. Also, given the anticipated percentage distribution that may be made, any recovery for losses in the NNU Case likely will be consumed in whole by the Loss Allocation in the APS Case. This is unfair because the APS-NNU Investors, unlike other APS clients with legitimate investments, will not, as anticipated in the Plan, obtain the benefit of freeing themselves from the APS enterprise by paying the Loss Allocation – they have no valid investments through the NNU

¹⁰ *Id.*, pp. 24-30.

¹¹ *Id.*, p. 29.

¹² *Id.*, p. 24.

¹³ *Id.*; see also *id.*, p. 25 n.8.

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Promissory Notes to roll over to another IRA or another custodian. In short, APS-NNU Investors will receive no consideration after being obligated to pay the Loss Allocation.

Thus, with regard to APS-NNU Investors, the NNU Receiver does not believe that the last statement method of valuation should be applied to the NNU Promissory Notes held in APS accounts. Not only will such a valuation be contrary to how investments in most Ponzi cases are valued and will only serve to perpetuate NNU's and APS's fraud,¹⁴ but it would be unfair based on the information provided below. In short, the NNU Receiver believes that there is ample evidence that the NNU Promissory Notes should be revalued in an amount of zero. Thus, in accordance with the Plan, the Receiver provides the following evidence demonstrating why a zero valuation is appropriate for NNU Promissory Notes.¹⁵

Evidence in Favor of Revaluing the NNU Promissory Notes

The Receiver believes that the evidence establishes that the NNU Promissory Notes held by APS-NNU Investors should be revalued at zero for at least three reasons.

First, in a letter from the NNU Receiver to APS dated April 4, 2013, a copy of which is attached as **Exhibit 3**, the NNU Receiver expressly notified APS that NNU "Promissory Notes have no value."¹⁶ Specifically, the NNU Receiver stated:

It is the [NNU] Receiver's opinion that as a consequence of the Receivership, the Promissory Notes have no value. This is because the Promissory Notes will not be paid by the Receiver, and therefore, the Promissory Notes issued by the National Note Entities are of no value. It is possible that holders of Promissory Notes may eventually receive some distribution from the Receivership, but the basis for this distribution will not be the Promissory Notes, but rather the amount of money that was invested in or loaned to the National Note Entities.

¹⁴ See, e.g., *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 234 (2d. Cir. 2011) (applying SIPA, the Court rejected last statement method of claims valuation, stating that it is not appropriate in a Ponzi setting. Applying a net principal investment method of valuation allowed the trustee to "unwind[], rather than legitimiz[e], the fraudulent scheme." (quoting and affirming *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. 122, 136 (Bankr. S.D.N.Y. 2010)).

¹⁵ This recommendation applies only to the NNU Promissory Notes held in the APS account. The NNU Receiver is not expressing any opinion about the valuation of other assets that may be held in the accounts.

¹⁶ Exh. 3, p. 1.

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The [NNU] Receiver offers this assessment to you so that [APS] can reduce or eliminate the notional value of the Promissory Notes that it is holding as the custodian of self-directed retirement accounts.¹⁷

This letter was provided to APS in an attempt to settle an ongoing dispute between the NNU Receiver and APS related to APS's charging of custodial fees. The dispute arose early in the NNU Case after the NNU Receiver posted information on the NNU receivership website, copies of which are **Exhibit 4**, notifying NNU Investors of improper custodial activity. APS threatened litigation related to the NNU Receiver's website content, and in attempt to conserve the resources of the NNU estate, the NNU Receiver agreed to remove some of the content from the website. APS, however was not satisfied by the Receiver's actions, and ultimately it filed a Motion to Intervene in the NNU Case, which was opposed by the NNU Receiver.¹⁸ The Court granted APS's Motion to Intervene,¹⁹ but APS never filed a complaint in intervention. During this entire process, commencing in August 2012, APS was advised numerous times by the NNU Receiver that NNU Promissory Notes had little if any remaining value.

Second, and related to the first point is that in all of its dealings with the NNU Receiver, APS continually took the position that it would not revalue the NNU Promissory Notes based on client direction, but rather needed the NNU Receiver to provide a valuation. The NNU Receiver informed APS that this was not correct. Ultimately, however, as noted above, the NNU Receiver provided a valuation of zero.²⁰ Despite its adamant stand that APS needed to receive a valuation from the NNU Receiver, when it got this valuation, it appears to have been ignored (and custodial fees likely continued to be charged). Then, subsequently in July 2013, again contrary to the position that it had taken with the NNU Receiver (and, we are told, some APS-NNU Investors), APS sent the letter attached hereto as **Exhibit 5**, requesting that it now be given permission from an APS-NNU Investor to write down the value of NNU Promissory Notes. The NNU Receiver does not know the extent to which APS offered this revaluation option to other APS-NNU Investors.

Third, the NNU Receiver is aware of numerous situations after the commencement of the NNU Case and prior to the commencement of the APS Case in which APS-NNU Investors attempted to have their NNU Promissory Notes revalued or their APS accounts holding NNU Promissory Notes closed. Attached hereto as **Exhibit 6** through **Exhibit 11** is correspondence

¹⁷ *Id.*

¹⁸ NNU Case Docket Nos. 101 & 136.

¹⁹ NNU Case Docket No. 239.

²⁰ Exh. 3.

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the NNU Receiver has obtained related to such issues. In reviewing these letters, a few points should be made: APS appears to have (a) encouraged its clients to invest with NNU and keep investments with NNU;²¹ (b) closed accounts and reported distributions that NNU Investors maintain were not made;²² (c) ignored or refused to revalue or close client accounts at their request;²³ (d) continued to charge fees despite information from clients of devalued accounts;²⁴ and (e) reported taxable distributions to the IRS related to NNU Promissory Notes on closed accounts.²⁵

Proposed Methodology for Revaluing

In light of APS's overvaluation of the NNU Promissory Notes, the NNU Receiver believes that it would be inequitable to value such Promissory Notes based on the proposed last statement method. As invited in the Plan, the NNU Receiver respectfully submits that the NNU Promissory Notes should be valued at zero. A zero valuation is wholly supported by the evidence above, and does not interfere with estate administration.²⁶ This methodology has the advantages of simplicity and avoiding the circumstances where APS customers might end up being obligated to pay additional amounts—where no recovery is likely—thereby compounding the losses they are facing and, as noted above, actually perpetuating the fraud these APS-NNU Investors have experienced. It is also consistent with how other custodians value investments in Ponzi schemes.²⁷

In proposing a zero valuation, the NNU Receiver considered other options, but from his perspective, they present enormous drawbacks in terms of complexity and inequity, such that they should not be adopted. For instance, if the NNU Promissory Notes were valued at 5% of

²¹ See Exh. 6.

²² *Id.*

²³ See Exhs. 7 - 8.

²⁴ See Exhs. 7 - 10.

²⁵ See Exhs. 7 & 10 - 11.

²⁶ For APS-NNU Investors who are “net winners” in the NNU Case and thus have been sued by the NNU Receiver, a zero valuation also obviates potential costs that both estates will likely incur in issues related to collection of false profits and payment of the Loss Allocation.

²⁷ See Exh. 12 (Equity Trust Company Form--when a customer demonstrates that debts are uncollectible, this entity distributes the assets to the beneficiary “with a value of \$1.00[]” which allows the customer to avoid adverse tax consequences and is spared the need to continue paying custodial fees on the valueless asset); Exh. 13 (Pensco Trust notice); Exh. 14 (email to NNU Receiver related to custodial accounts held at Entrust).

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the Net Principal Investment, as suggested by APS itself prior to the commencement of the APS Case,²⁸ the NNU Receiver believes that the valuation would need to be applied only to APS-NNU Investors who have received less than the projected rising tide threshold in the NNU Case, and thus who will actually receive a distribution in the Case. As a result, APS-NNU Investors who have already received returns on their Principal Investments sufficient to disqualify them from a distribution under a rising tide plan in the NNU Case would have their NNU Promissory Notes valued at zero. In the meanwhile, the NNU Promissory Notes of those APS-NNU Investors who will receive a distribution in the NNU Case under the rising tide method would be valued at 5% of the Net Principal Investment. This approach has the advantage of permitting those who have been defrauded twice to avoid having to pay the Loss Allocation in the APS Case when they will recover no return on their Net Principal Investment claim in the NNU Case. But, this option has significant disadvantages, including (a) complexity; (b) disparate treatment among those in the APS-NNU Investor class; (c) delay in administration in the APS Case given the long period of time before distributions may be paid in the NNU Case; and (d) the added administrative expense that would be incurred by both receivership estates. When this last point is considered, it is unclear if any net benefit would be obtained by the APS receivership estate from the Loss Allocation that would apply to these victims.²⁹

The NNU Receiver also considered different ways of actually paying the Loss Allocation, to avoid forcing APS-NNU Investors to advance money to the APS estate before receiving funds from the NNU estate. Such Investors could opt to have 10% of any NNU Case distribution they may receive in the future paid to the APS Receiver as their respective Loss Allocations. For those who do not receive a distribution, no Loss Allocation would apply. This option is based on the ultimate actual amount APS- NNU Investors receive from the NNU Case, not on any hypothetical valuation of the investment based on the face value of the NNU Promissory Note or the amount of the Net Principal Investment claim. Implementing this option is expected to be difficult and would add to the expense of the NNU estate in obtaining appropriate approvals from the Court. Other disadvantages include: (a) administrative costs in both cases associated with valuing and calculating and agreeing on amounts; (b) the potential inconsistent treatment of APS-NNU Investors who received false profits on their NNU Promissory Notes and are subject to clawback claims in the NNU Case; (c) the potential for objection by the APS-NNU Investors to this approach; and (d) delay in administering the APS Case due to the early-stage status of claims administration in the NNU Case.

²⁸ Exh. 5.

²⁹ Based on the books and records in his custody, the NNU Receiver believes that, at most, the Net Principal Investment claims of APS-NNU Investors is only approximately \$9.2 million (as opposed to the approximately \$16.3 million based on the face value of the NNU Promissory Notes). *See* Exh. 2. Five percent of \$9.2 million is \$463,703.00, and thus the 10% Loss Allocation for all of these APS-NNU Investors only totals \$46,370.00. When the Loss Allocations for investors above the rising tide distribution level are removed, the Loss Allocation is expected to be much less.

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Conclusion

For all of the reasons discussed, the NNU Receiver believes that NNU Promissory Notes held by APS-NNU Investors should be valued at zero. This is consistent with the evidence and makes sense in light of the fact that the NNU Promissory Notes were issued as part of a Ponzi scheme. Such a valuation is necessary to prevent inequitable treatment of APS-NNU Investors.

Please contact me if you require further information or would like to discuss the proposals that are made herein.

Sincerely,

DORSEY & WHITNEY LLP

A handwritten signature in blue ink, appearing to read "Peggy Hunt", written over the printed name.

Peggy Hunt
Partner

PH:cl

Enclosures

cc: R. Wayne Klein, Receiver (via email)
Daniel J. Wadley, U.S. Securities and Exchange Commission (via email)