

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,)
)
Plaintiff,)
)
v.)
)
BURTON DOUGLAS MORRISS,)
ACARTHA GROUP, LLC,)
MIC VII, LLC,)
ACARTHA TECHNOLOGY PARTNERS, LP, and)
GRYPHON INVESTMENTS III, LLC,)
)
Defendants, and)
)
MORRISS HOLDINGS, LLC,)
)
Relief Defendant.)
_____)

Case No. 4:12-CV-00080-CEJ

THIRD INTERIM STATUS REPORT OF RECEIVER

Claire M. Schenk (the “Receiver”), the Receiver for Defendants Acartha Group, LLC (“Acartha Group”), Acartha Technology Partners, LP (“ATP”), MCI VII, LLC (“MCI VII”), and Gryphon Investments III, LLC (“Gryphon Investments”) (collectively, the “Receivership Entities”), submits her Third Interim Status Report relative to acts and transactions undertaken since the submission of her Second Interim Status Report on April 20, 2012.

I. BACKGROUND OF THE RECEIVERSHIP

Acartha Group is a Delaware limited liability company incorporated in February 2003, with its principal place of business in Clayton, Missouri. Prior to the creation of this Receivership, it also maintained an office in East Brunswick, New Jersey. Acartha Group was established as a private equity fund management company. Acartha Group is the managing member of MIC VII and also manages Gryphon Investments.

Ex. A

MIC VII is a Delaware limited liability company incorporated in March 2005, with its principal place of business in Clayton, Missouri. MCI VII is a private equity fund formed to invest in early to mid-stage companies primarily in the financial and technology sectors.

ATP is a Delaware Limited Partnership organized in April 2008, with its principal place of business in Clayton, Missouri. ATP is a private equity fund formed for the same purpose as MIC VII.

Gryphon Investments is a Delaware limited liability company incorporated in February 2003, with its principal place of business in Clayton, Missouri. Gryphon Investments is the general partner of ATP.

On January 17, 2012, United States District Court for the Eastern District of Missouri (the "Court") appointed the Receiver as receiver for the Receivership Entities. The Receiver's authority, duties and obligations are set forth in the Order Appointing Receiver entered January 17, 2012 (Dkt. No. 16) (the "Receivership Order"). The overall function of the Receiver as set out in the Receivership Order is to administer and manage the business affairs and assets of the Receivership Entities, act as the managing member or partner of the Receivership Entities, marshal and safeguard all of the assets of the Receivership Entities and take such actions as are necessary to protect investors. In furtherance of these objectives and following her appointment, the Receiver took the actions outlined in the First and Second Interim Status Reports and has continued her efforts as outlined below.

II. OPERATION OF THE RECEIVERSHIP

A. General Operations

During the early months of the Receivership, much of the Receiver's focus was upon providing notice to the relevant parties, obtaining a turnover of Receivership property, gathering funds belonging to the Receivership, and returning investor funds maintained by Acartha Special Situation Funds, LLC. During this reporting period, the Receiver continued to attend to completion of those tasks. However, significant efforts have also been devoted by the Receiver to: preservation of the value of the Receivership entities' existing portfolio investments; tax and accounting matters, including preparation of returns for 2011; and the pursuit of Receivership claims. An overview of these matters is provided within this report.

B. Business Operations

The Receivership entities' existing investments include illiquid interests in: Librato, Inc. (cloud management services); Tervela, Inc. (data transfer services); Pollenware (cash flow optimization services); Clearbrook (asset allocation advice services); and Circuit, which holds an interest in Logic Source (print/paper procurement processing and outsourcing). Each of these companies is in a different stage of its development. However, none of them yet generate enough revenue to make them completely self-sufficient. Therefore, each entity tends to require additional venture capital investments or other financing to maintain and sustain its growth. For this and other reasons, including various restrictions within the documentation, the interests are generally not immediately saleable. The time consuming process of monitoring and facilitating the capital calls and financing needs of these portfolio companies has proven to be one of the central challenges of Receivership operations.

Given that the Receivership entities are not in a position to respond directly to the financing needs of these companies or to raise funds from new investors, the Receiver, where appropriate, has facilitated contacts with existing investors so that these investors have the option of follow on investments. As a general matter, continued investments tend to minimize or avoid the dilutive impact which results from the injection of capital from new investors seeking to claim significant interests in the portfolio companies. Responding to the funding needs of the Receivership entities' portfolio companies involves: communications with investors to keep them updated and to supply pertinent documentation; analysis of participation rights and calculation of share allocations; arranging and facilitating investor calls directly with the portfolio entities so that each investor may complete his or her own due diligence; and a legal review of deal documentation and the Receivership entities' rights, *e.g.*, whether consent should be granted as to various transaction or alternatively blocking rights exercised as appropriate.¹

In order to facilitate the flow of information to investors, the Receiver created a secure investor extranet website. Interested investors are allowed access following contact with the Receiver's investment fund manager and execution of a nondisclosure agreement ("NDA"). In those instances where investment concerns have indicated that they require a direct NDA, alternative arrangements have been made for the sharing of information. The Receiver has continued to update its general website which is completely available to the general public.

¹ The sale of any Receivership interests will be presented to the Court at the appropriate point in time for review and approval prior to consummation of the transaction.

C. Personnel

Pursuant to paragraph 4 of the Receivership Order, the Receiver may “employ legal counsel, actuaries, accountants, clerks, consultants and assistants as the Receiver deems necessary and to fix and pay their reasonable compensation and reasonable expenses.”² In line with this authority, and following the receipt of various proposals and discussions and interviews with various service professionals, the Receiver made arrangements with those professionals listed in the Receiver’s Second Interim Status Report. Those professionals, including, Thompson Coburn LLP, (counsel to the Receiver), Segue Partners (“Segue”), (Fund Administrator), and FTL Capital LLC (“FTL”) (Business Advisors to the Receiver), have continued to provide services during this reporting period.

In addition to the foregoing, the services of an accounting firm are required to prepare the tax returns for the Receivership Entities. To secure the services of an accounting firm and personnel with the appropriate background, expertise and pricing strategy, the Receiver issued a Request for Proposal (the “RFP”) to a number of potentially qualified tax accounting firms. See Exhibit 1. RFPs were provided to those firms indicating an interest in providing services to the Receiver. Additional names were sought from various sources, including the Commission, and provided to interested parties. Five responses were received to the RFP. Following discussions with the candidates, interviews and an evaluation of the responses, the firm of CliftonLarsonAllen (“CLA”) was selected. CLA was selected based upon its relevant expertise (which included Receivership work involving the Commission) and pricing (which included a flat rate for the returns to be filed). Furthermore, the CLA tax partner, Tim O’Shaughnessy, is

² Paragraph 22 of the Receivership Order provides that no bond is required and that Receivership personnel are not liable for any loss or damage except for an act of gross negligence. *See* Receivership Order, Dkt. No. 16, at p. 7.

located in St. Louis which will allow for greater efficiency in the sharing of relevant information. See June 15, 2012 CLA Proposal (Exhibit 2) and executed engagement letter (Exhibit 3).

D. Tax Matters

Since the date of its engagement, CLA has been working closely with the Receiver in preparation for the filing of tax returns for the year 2011.³ As a preliminary matter, CLA and the Receiver have expended considerable due diligence efforts to ensure that the appropriate returns are filed by the Receivership entities and the related entities. As part of their due diligence efforts, CLA and the Receiver have conducted an extensive search for the appropriate corporate governance documents which they have analyzed and discussed with multiple parties. They have reviewed quick book and other bookkeeping records, conducted interviews of the Receivership entities' former accountants and managers, and continued to request the turnover of all Receivership documentation. During this reporting period, turn over requests have been made to former accountants, auditors and personnel of the Receivership entities.

Based upon these due diligence efforts, CLA advised the Receiver that it anticipates filing returns for the following entities: Acartha Group, LLC; MIC VII, LLC; Acartha Tech Partners, LLC; Gryphon Investments III, LLC; Clearbrook Acquisition, LLC; Integrien Acquisition, LLC; Integrien Acquisition II, LLC; Evergrid MIC VII, LLC; Tervela Acquisition, LLC; Tervela Acquisition II, LLC; Tervela Acquisition III, LLC; Acartha Merchant Partners, LLC; Morriss Administration d/b/a Acartha Group Funding, LLC; Acartha Special Situations Funding, LLC; Integrien Acquisition Capital II, LLC; and Librato Acquisition II, LLC. CLA has preliminarily identified these entities based upon information indicating that Acartha Group, LLC currently serves as the Managing Member and/or the relationship between the entities.

³ Prior to CLA's engagement, Segue worked with the Receiver to obtain extensions of the return due dates.

E. Chapter 7 Bankruptcy of Burton Douglas Morriss

As described in the First and Second Status Reports of the Receiver, Burton Douglass Morriss is the subject of bankruptcy proceedings commenced on January 9, 2012 pending before the Bankruptcy Court for the Eastern District of Missouri (Eastern Division) (the “Bankruptcy Court”) as Case No. 12-40164. During this reporting period, Transcripts of the Meeting of Creditors and 2004 exam held on March 28, 2012 were received in early April and briefly reviewed; Mr. Morris asserted his 5th Amendment privilege in declining to answer every question posed.

Objections to Mr. Morris’ Section 727 discharge, and the Section 523 dischargeability of the Receiver’s claims against Mr. Morris were lodged and granted, resulting in an extension of the deadline to file complaints objecting to discharge and dischargeability to February 8, 2013. A deadline for filing proofs of claim for purposes of sharing in any distribution of assets of the estate was established. This deadline is October 17, 2012.

The Office of the U.S. Trustee and the Chapter 7 Trustee objected to the effort by Morris bankruptcy counsel, Les Lane to withdraw from services without filing a fee application; Lane filed a fee application which revealed failure to disclose a conflict and the US Trustee and Chapter 7 Trustee objected to Lane’s fee application and requested disgorgement of the \$12,000 in fees paid to him. Bankruptcy Judge Kathy Surratt-States ultimately granted the relief sought by the Trustees. The Trustee is following up on the disgorgement relief.

The 341 Meeting is continued to August 17 and is not expected to be concluded given that the Debtor has asserted a 5th Amendment privilege to the extent he has appeared to give testimony on the record. Also, the Trustee toured the Morris residence and continues to pursue

potential assets, including a hunting club license. A liquidator was employed to assist in liquidation efforts.

F. Receiver's Accounting

The Receiver's Standardized Fund Accounting Report ("SFAR") for the period from April 1, 2012 through June 30, 2012 (the "SFAR Reporting Period") is attached hereto as Exhibit 4 and will be submitted as support for the Receiver's Second Interim Application for Allowance and Payment of Fees and Expenses. As of the date of the filing of this Third Interim Status Report, the Receiver's First Interim Application for Allowance and Payment of Fees and Expenses remained pending. For that reason, the service professionals listed in the Fee Application remained uncompensated and expenses unreimbursed.⁴ The SFAR sets forth the funds received and disbursed from the Receivership estate during the SFAR Reporting Period and includes the amount of cash on hand, the amount of accrued administrative expenses, and the amount of unencumbered funds in the estate. The information reflected in the SFAR is based on records and information currently available to the Receiver. The Receiver and her advisors are continuing with their evaluation and analysis of the assets and liabilities of the Receivership estate.

G. Claims

The Receiver continues to evaluate information pertinent to the value of claims made against and those which may be made on behalf of the Receivership estates. During this

⁴ The Receiver recently filed a Supplemental memorandum to inform the Court that Segue has indicated that it may terminate its relationship with the Receiver unless it receives payment. As stated in its filing, the Receiver is concerned that valuable time will be lost in transferring this function and that increased costs will be incurred due to the significant amount of time required to educate a new fund manager about the complexities of the Receivership Entities. As a result, replacing Segue may result in additional harm to the investors and their interests.

reporting period, several more claims were received from pre-Receivership vendors and larger claims were received from two additional former employees in addition to the claim previously filed by former employee Ameet Patel. The new claims were submitted by Wynne Morriss, former counsel to the Receivership entities (\$456,172.73) and Hany Teylouni, Managing Director (\$338,598.45) and are attached hereto as Exhibits 5 and 6. The allegations of these claims primarily involve unpaid wages and expenses. Another claim was submitted on behalf of Eric Sarasin in the amount of \$3.5 million and is attached hereto as Exhibit 7. In his claim Mr. Sarasin asserts that these monies were advanced by him with the expectation of an investment interest which he did not receive and that the funds did not represent a loan. These potential creditors, and others, have been informed that their claims will be considered by the Receiver and the Court, at the proper point in time in this proceeding. The Receiver has begun preparation of a claims bar date process for submission to the Court.

The Receiver has also continued to investigate the litigation filed in state court, *Nixon, et al. v. Burton Douglas Morriss, et al.*, Case No. 11SL-CC04718 (Circuit Court for St. Louis County, Missouri) (the "State Court Litigation"). As previously reported, claims have been asserted by the Receiver against the defendant, B. Douglas Morriss, and a former executive of the Receivership entities, Dixon Brown. These claims seek a recovery of the \$9.1 million transferred from the Receivership entities.

On August 13, 2012, the Receiver submitted a proof of loss to Maryland Casualty Company under the Commercial Crime Coverage Form of its policy. This claim is based upon the dishonest acts involving Douglas Morriss as described in this proceeding by the Commission and which resulted in the transfer of substantial funds from the Receivership entities. A response has not yet been received.

H. Litigation

Pursuant to paragraph 6 of the Receivership Order, and with the assistance of Thompson Coburn LLP as counsel, the Receiver continued to engage in litigation relative to the Receivership entities. While the Receiver consented to the entry of a Permanent Injunction as moved by the Plaintiff in the Receivership action, the Receiver has nonetheless been obligated to participate in discovery related to the litigation. To that extent, the Receiver has continued to obtain, monitor and make available the business records of the Receivership entities. In addition, counsel for the Receiver has continued to analyze the business records of the Receivership entities, both to assist in the defense of claims asserted against those entities (or assist in the prosecution of claims belonging to those entities). Last, in an action styled Acartha Group LLC v. Morriss Holdings, LLC, Case No. 4:12-cv-01142-CEJ (E.D. Mo.), the Receiver filed suit against relief Defendant Morriss Holdings to recover from it in excess of \$7 million paid to Morriss Holdings by various of the Receivership Entities.

VIII. CONCLUSION

The Receiver will continue to update this Report on a periodic basis to summarize all relevant Receivership activities.

Dated: August 14, 2012

Respectfully submitted,

/s/ Claire M. Schenk

Claire M. Schenk, Receiver