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6 Attorneys for Objecting Parties In Interest,
7 Juanita D. Adamina, et al.

8 UNITED STATES BANKRUPTCY COURT
9 CENTRAL DISTRICT OF CALIFORNIA
10 NORTHERN DIVISION

11 In re

12 REED E. SLATKIN and Substantively
13 Consolidated Affiliates TOPSIGHT
OREGON, LLC, and REED SLATKIN
INVESTMENT CLUB, L.P.,

17 Debtors.

) Case No. ND-01-11549-RR [Substantively
) consolidated with former Case No. ND-01-
) 12990-RR]

) [Chapter 11]

) Judge: Hon. Robin L. Riblet

) DECLARATION OF M. FREDDIE
) REISS IN SUPPORT OF INTERESTED
) PARTIES' REPLY TO TRUSTEE'S AND
) CREDITORS' COMMITTEE'S
) RESPONSES TO "STOCKBROKER"
) OBJECTIONS TO PLAN
) CONFIRMATION

) Date: June 2, 2003

) Time: 10:00 a.m.

) Place: 1415 State Street

) Courtroom 201

) Santa Barbara, California

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Declaration of M. Freddie Reiss

I, M. Freddie Reiss, declare:

I am a senior managing director in the Financial Restructuring practice of FTI Consulting, Inc. ("FTI"), and I am the partner in charge of FTI's West Region Financial Restructuring practice. Prior to FTI's acquisition of PricewaterhouseCoopers LLP's ("PwC's") Business Recovery Services group in August 2002, I was the managing partner of the Corporate Recovery practice at PwC, having founded the West Coast bankruptcy practice at Price Waterhouse LLP¹ in 1998.

I have extensive experience in local and national insolvency, reorganization and bankruptcy matters, financial analysis and similar disciplines. I have served as a financial advisor to debtors and debtors-in-possession, Chapter 7 trustees, secured lender groups, unsecured creditor committees, bondholder committees and equity committees in out-of-court restructurings, bankruptcies and liquidations. I am also serving as an examiner in the Daewoo bankruptcy matter in the Central District of California. Some of the engagements under direct supervision were Baldwin Builders, First Lenders Indemnity Corporation ("FLIC"), Orange County Investors' Pool, First Executive Corporation, America West Airlines, Circle K Corporation, Financial Corporation of America, The Edwards Theatres, Euro Disney, and The Musicland Stores.

I am a Certified Public Accountant, licensed to practice in the states of California and New York. I am a Certified Insolvency and Restructuring Advisor and a Fellow of the American College of Bankruptcy. A complete description of my professional credentials, background and publications is attached as Exhibit 1. I have personal knowledge of the facts set forth herein, and, if called as a witness, could competently testify thereto.

Scope of Opinion

FTI was retained by Danning, Gill, Diamond & Kollitz on or about May 9, 2002 for purposes of, among other things, analyzing the business affairs of Reed Slatkin; determining whether Reed Slatkin was solvent and drawing conclusions therefrom, such as whether Reed Slatkin was operating a Ponzi scheme.

Definition of a Ponzi Scheme

In this circuit, a Ponzi scheme is defined as:

"a fraudulent arrangement in which an entity makes payments to investors from monies obtained from later investors rather than from any 'profits' from the underlying business venture. The fraud consists of funneling proceeds received from new investors to previous investors in the guise of profits from the alleged business venture, thereby cultivating an illusion that a legitimate profit-making business opportunity exists and inducing further investment." *In re United Energy Corp.*, 944

¹ On July 1, 1999, Price Waterhouse LLP and Coopers & Lybrand LLP merged to form PricewaterhouseCoopers LLP.

F. 2d 589, 590 n. 1 (9th Cir. 1991)

Based on this definition, there are three key components in the Ponzi scheme definition.

1. whether payments to investors comes only from money received from new investors or partly from money received from net investors,
2. the promoter is insolvent at inception and becomes increasingly insolvent with each successive investment, and
3. the promoter does not conduct a legitimate profit-making business.

Opinion

Reed Slatkin was not operating a Ponzi scheme as that activity is defined in this circuit. The Chapter 11 trustee has not proven that the three key components of a Ponzi scheme have been satisfied, the failure of a single component being sufficient to disprove a Ponzi scheme.

1. Reed Slatkin earned tens of millions of dollars from investing and as a result had significant investment funds from which to pay investors. The Chapter 11 trustee has not proven that payments to investors were comprised solely of money received from new investors.
2. At least at January 31, 1999, Slatkin was solvent by at least \$14 million. See Exhibit 2. Slatkin may have been solvent at other times between 1986 and the petition date; however, I have not determined or included the value of substantial other assets. Similarly, the Chapter 11 trustee has not calculated the value of many of the Slatkin assets at various times during this same interval.
3. Reed Slatkin was operating a profitable business.

Information Relied Upon

In analyzing the business affairs of Reed Slatkin, we requested access to Reed Slatkin's books and records. The trustee has indicated that there are two million documents² in this matter. Copies of some of the books and records are located in a document depository maintained by R. Todd Neilsson, Chapter 11 trustee. These copies are stored in approximately 300 banker's boxes. We have been given access to this depository. However, due to the manner in which the copies are maintained, we have not been able to make a thorough review of all the copies. Furthermore, we have only recently been given indexes to the copies. The indexes do not have sufficient detail to provide us with substantial information regarding the contents of the copies.

We are aware that there are other books and records which are not in the document depository and we have not yet been given access to these documents. Thus, our analysis

² First Interim Report of the Trustee and the Creditors Committee, page 35, line 7,

is limited to only those documents we have been able to obtain. If additional information is made available or comes to our attention, we reserve the right to modify this report.

The financial information in this case is vast. The Chapter 11 trustee's accountant, through February 28, 2003, has incurred nearly \$1.9 million representing over ten thousand hours of effort sorting through books and records and performing various financial analysis. See Exhibit 3. The Chapter 11 trustee's accountant has "... examined the approximately \$1.5 billion which flowed between 63 bank accounts and 318 brokerage accounts...analyzing and dissecting Slatkin's financial dealings over a 15-year period."³

Basis Of Opinion

Payments to Investors

The Chapter 11 trustee states, "Reed Slatkin earned a net profit of approximately \$18 million⁴." "...Slatkin realized a gain of approximately \$65 million." The Chapter 11 trustee reports Slatkin made over \$400,000 in 1995⁵. Furthermore, Slatkin earned tens of millions of dollars in investment income and investment profits. In 1996 and 1999, Slatkin, collectively, reported over \$1 million in interest income, over \$400,000 in dividend income, and over \$40 million in net gains from selling investments (with total proceeds in excess of \$110 million). See Exhibit 4. Despite the admission by the Chapter 11 trustee and the inclusion of tens of millions of income and profit in the Slatkin's tax returns, the Chapter 11 trustee still says that payments to investors were based on "...using other investors' money, and not profits actually earned on investments."⁶ However, the Chapter 11 trustee has not produced a coherent analysis of Slatkin's sources and uses of cash to prove that payments to investors came solely from new investor proceeds.

Solvency

The Chapter 11 trustee has not prepared any type of solvency analysis in this matter. The Chapter 11 trustee admits that there "numerous" assets in the Slatkin estate, including "corporations, partnerships, real estate, personal property, stock, jewelry, collections, automobiles, airplanes and other saleable assets."⁷ Furthermore, the Chapter 11 trustee had not obtained values of all the assets at the time of his first report and with respect to some of the securities, "Many of these securities are not publicly traded and do not have a readily determinable value." For our purposes, we limited our analysis to include only the cash and fair value of securities held by brokers for the benefit of Slatkin and the value of only one of the other many Slatkin assets, the Earthlink stock.

³ First Interim Report of the Trustee and the Creditors Committee, page 17, line 17.

⁴ First Interim Report of the Trustee and the Creditors Committee, page 5, line 13.

⁵ First Interim Report of the Trustee and the Creditors Committee, page 19, line 1.

⁶ First Interim Report of the Trustee and the Creditors Committee, page 5, line 20.

⁷ First Interim Fee Application For Compensation And Reimbursement Of Costs By Chapter 11 Trustee, page 6, lines 2-5.

Declaration of M. Freddie Reiss

We obtained copies of broker statements from 23 brokerage accounts. Using these statements, we summarized the net fair value of each of these accounts, including cash, fair value of the investments, and margin balances. At January 31, 1999, the net fair value of these broker accounts totaled \$22 million. See Exhibit 5.

We also valued the Earthlink stock. At January 31, 1999, Slatkin held approximately 2 million shares of Earthlink stock. The number of shares was derived from information obtained through Securities and Exchange Commission documents and was reconciled to information provided by the Chapter 11 trustee. See Exhibit 6. The closing price of a single share of Earthlink stock on January 31, 1999 was \$79.88. See Exhibit 7. As a result, we determined the total value of Earthlink stock held by Slatkin to be approximately \$153 million. See Exhibit 6.

Slatkin's holdings at January 31, 1999 comprise approximately 6 percent of the outstanding shares of Earthlink. We did not assign a trading premium or discount to this block of shares, despite the tendency of controlling blocks of shares to trade at a premium. See Exhibit 8. Furthermore, there was sufficient volume in the number of shares trading each day as to not present limitations on the ability of Slatkin to sell Earthlink shares. See Exhibit 7.

Slatkin's shares were registered; however, as an insider, he was subject to certain rules which place some restrictions on when he can purchase and sell Earthlink stock. I have seen the restriction legend contained on the back of stock certificate No. 115 for 1,811,620 shares of Earthlink. See Exhibit 9. I am familiar with the Securities and Exchange Commission rules to which this legend refers. However, based on the volume of Earthlink shares trading around January 31, 1999 (see Exhibit 7), I do not believe the insider restrictions impaired the value of the Earthlink shares held by Slatkin at January 31, 1999.

Based on this effort, we computed the fair value of only the 23 broker accounts and the Earthlink stock to be approximately \$176 million at January 31, 1999. See Exhibit 2.

We then obtained the total amount owed to the investors at January 31, 1999. This analysis consisted to two components. The first component was derived from the proofs of claim forms filed by the investors. Using a cash in and cash out method, the investor balances were tracked from initial deposit through the petition date. The second component was derived from information obtained from defendants to recovery actions filed by the Chapter 11 trustee. Again, using a cash in and cash out method, the investor balances were tracked from initial deposit through final payment. Based on this analysis, the amount owed to investors as of January 31, 1999 was approximately \$161 million⁸.

⁸ This analysis excludes the amounts owed to some investors on January 31, 1999, but which investors were subsequently paid in full prior to the bankruptcy filing.

Based on the value of the broker accounts, the Earthlink stock and the amount owed to investors as of January 31, 1999, Slatkin was solvent by approximately \$14 million. This analysis does not include the value of other Slatkin assets.

Profit-making Business Activity

Reed Slatkin earned millions of dollars from his investing activities. The Chapter 11 trustee states, "Reed Slatkin earned a net profit of approximately \$18 million⁹." "...Slatkin realized a gain of approximately \$65 million." The Chapter 11 trustee reports Slatkin made over \$400,000 in 1995¹⁰. Furthermore, Slatkin earned tens of millions of dollars in investment income and investment profits. In 1996 and 1999, Slatkin, collectively, reported over \$1 million in interest income, over \$400,000 in dividend income, and over \$40 million in net gains from selling investments, including the sale of over 6 million shares with total proceeds in excess of \$110 million. See Exhibit 4.

Also, declarations filed in support of various pleadings demonstrate Slatkin was a stockbroker. See the Declaration Of Andrew Savas, the Declaration Of Robert London and the Declaration of William Hutchins, M.D. included in the Defendants' Compendium Of Declaration In Support Of Defendants' Motion For Summary Judgment Or, Alternately, Summary Adjudication and the Declaration of Glenn Johnson In Opposition To Trustee's Motion For Partial Summary Judgment.

Based on the millions of dollars in profits and the information contained in the declarations reference above, Slatkin was operating a profitable business through at least December 31, 1999.

Declaration of Grant W. Newton

I have just received the Declaration of Grant W. Newton In Support Of Plan Confirmation (the "Newton Declaration"). Based on my initial reading of the the Newton Declaration, the Newton Declaration:

1. does not state that investor distributions were funded solely from new investor proceeds;
2. infers impropriety with investor distributions approximating investor proceeds¹¹, but provides no analysis of fair value of the underlying assets to which one investor is disposing and another is acquiring;
3. refers only to publicly-traded securities and cash in the analysis to prove Ponzi scheme¹², and remains silent with respect to the other assets in the Slatkin estate;

⁹ First Interim Report of the Trustee and the Creditors Committee, page 5, line 13.

¹⁰ First Interim Report of the Trustee and the Creditors Committee, page 19, line 1.

¹¹ Newton Declaration, page 7, line 28, "...money disbursed to investors was very high in proportion to money received from investors."

¹² Newton Declaration, page 8, lines 1-7, "...dollar value of publicly traded securities and cash...", "...invested in publicly traded securities...", and profits Slatkin earned on his transactions in publicly traded securities..."

4. Newton excludes Earthlink stock in his analysis¹³, and only uses the explanation that the shares were not publicly available purchases. To exclude them, considering their significant value without any evidence they are not assets of the estate, is highly questionable; and
5. admits that Slatkin earned trading profits¹⁴.

I have not had sufficient time to perform an in-depth analysis of the Newton Declaration, and reserve the right to modify my declaration to incorporate the results of my analysis of the Newton Declaration.

Conclusion

Despite issuing a report and incurring thousands of hours of time and millions of dollars in fees, neither the Chapter 11 trustee nor his accountants have put forth in his first report any financial information to prove Reed Slatkin was operating a Ponzi scheme.

1. The Chapter 11 trustee has not proven that payments to investors came solely from new investor funds.
2. The Chapter 11 trustee has not proved that Slatkin was insolvent, at what times he may have been insolvent, and the extent to which he may have been insolvent, and
3. The Chapter 11 trustee has ignored evidence that proves Slatkin was operating a profitable business.

Rather, the Chapter 11 trustee has relied solely on Reed Slatkin's admission of operating a Ponzi scheme to pursue avoidance actions.

Since Reed Slatkin was solvent, was operating a profitable investing business, and not operating a Ponzi scheme, as it is defined in this circuit, as of January 1999, the Chapter 11 trustee's avoidance actions on transfers prior to that date are inappropriate.

If other information comes to my attention, I reserve the right to modify my declaration.

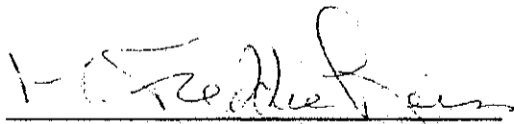
¹³ Newton Declaration, page 9, footnote 4, line 24, "...for purposes of assessing the value of Slatkin's securities conceivably held for the benefit of his investors compared to the amounts he owed investors on account of purported purchases of securities on behalf of investors, I have excluded Slatkin's Earthlink investment."

¹⁴ Newton Declaration, page 8, line 5, "...the profits Slatkin earned on his transactions in publicly traded securities was very small in comparison..."

Declaration of M. Freddie Reiss

I declare under penalty of perjury, under the laws of the United States of America, that the foregoing is true and correct to the best of my knowledge, information and belief.

Executed this 21th day of May, 2003 at Los Angeles, California.



M. Freddie Reiss

Declaration of M. Freddie Reiss

Exhibits

<u>Exhibit #</u>	<u>Description</u>
1	M. Freddie Reiss curricula vitae
2	Solvency Computation
3	Summary of Neilson Elggren fees
4	1996 and 1999 tax return analysis
5	Broker statement analysis at January 31, 1999
6	Earthlink stock analysis at January 31, 1999
7	Earthlink price/volume chart
8	Comparative target stock analysis
9	Earthlink restriction legend