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CLIFFORD J. PROUD
U.S. MAGISTRATE JUDGE
SOUTHERN DISTRICT OF ILLINOIS
EAST ST. LOUIS OFFICE

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

UNITED STATES OF AMERICA, Plaintiff, vs. NICHOLAS A. SMIRNOW a/k/a Nicoloy Smirnow, Alexander Judizcev, Nicholas Kachura, and Jeff Prozorowiczm, Defendant.	Case No. 10-M-6147-CJP

AFFIDAVIT IN SUPPORT OF CRIMINAL COMPLAINT

I, Postal Inspector Jacob M. Gholson, being first duly sworn, hereby depose and state as follows:

1. I am a Postal Inspector with the United States Postal Inspection Service, and have been since March, 2008. I have been working mail fraud cases since July 2008.

Overview of scam

2. As is detailed more fully within, Pathway to Prosperity ("P-2-P") was an internet Ponzi scheme that promised investors worldwide very high returns with little or no risk. P-2-P purported to afford to the average person the opportunity to take advantage of investment vehicles ostensibly available to only the very rich. As represented to investors, by investing with P-2-P, the average investor would supposedly pool his or her money with that of other investors to "piggyback" on the investment of P-2-P and its principal, **NICHOLAS A. SMIRNOW ("SMIRNOW")**.

3. Financial records of payment processors utilized by P-2-P to collect investment

funds from investors show that approximately 40,000 investors in 120 countries established accounts with P-2-P. Despite the fact that the investment was supposedly "guaranteed," investors lost approximately $70 million as a result of **SMIRNOW'S** actions.

Smirnow's pathway to prosperity

4. The investigation of P-2-P began when the Government received a referral from the Illinois Securities Department concerning an elderly Southern District of Illinois resident who had made a substantial investment in P-2-P.

5. I learned that P-2-P had an internet website and accessed its content through Internet Archive, which maintains a digital library of internet sites. [1]

6. An archived version of www.pathway-2-prosperity.net captured on December 29, 2007, describes the "P-2-P Network" as follows:

> 'P-2-P Network' is a long term "private" investment program, investing in various online and offline activities. Profits from these investments are shared with Members and invested in stable long term investments, to guarantee our program's stability for the long term.

7. P-2-P's web site describe how investors could pool their funds with others and ride the coattails of P-2-P's purported financial success:

- "In 99% of cases, the average person does not have enough 'liquid cash' to invest that can earn the high interest rates the millionaires enjoy"
- "We will assist you by allowing your funds to 'piggy-back' on ours... returns earned in the "P-2-P Network" Private Fund is totally out of reach

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[1] The Government obtained a Certificate of Authenticity (pursuant to F.R.E. 902(11)) from Internet Archive for the P-2-P's web sites described in this affidavit.

for the average individual !!"

8. P-2-P promised investors exorbitant returns. P-2-P's website offered 7, 15, 30 and 60 day "plans." Seven day plans returned 1.5% daily, 15 day plans returned 1.75% daily, 30 day plans returned 2% daily, and 60 day plans offered 2.5% daily.

9. The investment was "guaranteed," according to the website, implying that an investor's funds were safe:

> "Yes, we guarantee every external deposit you make into 'P-2-P Network'!!" .... The most important aspect of our personal investments, which range from low, medium to high returns are based on the fact that our principal investment is always guaranteed. If we did not have this in place, we would not feel comfortable with our own money sitting in various investments - large sums usually make anyone cautious and a bit shaky around the knees.

10. In addition to P-2-P's own website, I discovered that P-2-P's investment scheme was marketed on other websites, including High Yield Investment Program forums, which I was able to access directly through the internet. These websites included TalkGold.com, MoneyMakerGroup.com WorldLawDirect.com and ASAMonitor.com.

11. On MoneyMakerGroup.com's website, a posting dated February 24, 2007 which also contained a link to P-2-P's website, made substantially identical claims to those found on P-2-P's website.

12. TalkGold.com promotes high yield investment programs. There was a posting there by "Nicholas Smirnow - CEO, R.D. Direct, P-2-P Network - Program Founder, Pathway 2 Propserity Group - Group Founder," listing a Canadian phone number, an email address with a Canadian domain, and the URL for P-2-P's web site.

13. Based upon the claims made in P-2-P's website, P-2-P appears to bear the indicia

of a "high-yield investment program."[2]

14. A. "High-yield" investment program ("HYIP') is a term used to describe a type of scam in which investors are offered unrealistic and excessive rates of returns for investments that are reported to be safe. While originally "high-yield" investments referred to a legitimate, but speculative investment in the 1980s involving junk bonds, the term came to be associated with scams promising investment returns disproportionate to the risks involved, where the source of the returns was obscured, involved some esoteric aspect of supposedly international finance, entailed secrecy and did not actually involve investments that could return the promised yield.[3]

15. P-2-P attempted to distance itself from HYIPs and in the course of accurately describing what a HYIP was, claimed that P-2-P was not such a scheme.

> IMPORTANT NOTE: This is NOT a H.Y.I.P. site... We do NOT believe in them! You must stay away at all costs! You must know how these guys use funds from one investor to pay the next investors' commission - it is a highly illegal practice. It is fairly simple to do, as they set the percentages in such a way that there is enough to pay the next guy and run for periods of up to a year! During this time, they do not invest your money - their pockets just get bigger and bigger until their H.Y.I.P. cannot sustain itself and collapses. Keep this in mind: "The bigger the return on offer, the louder the warning bells should sound!" Anyway, our rule is simpler... STAY AWAY! [4]

16. While denying that P-2-P was a HYIP, the website admitted that P-2-P utilized

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[2] Declaration of Professor James E. Byrne, Attachment A, paragraphs 14 *et seq.* Professor Byrne is an expert on high yield investment scams and was asked to render an expert opinion on the representations made on P-2-P's web sites. Byrne's Declaration is hereinafter referred to as the "Byrne Declaration."

[3] Byrne Declaration at paragraph 23 *et seq.*

[4] Professor Byrne states that it is common for high yield investment scams to make such disclaimers. Byrne Declaration at paragraph 44.

software developed for HYIPs:

> It is ironic though ...... when we asked our programmer to write a management tool where we can manage Members' returns online, in a web based application, he came back within a few days and gave us a real good laugh !! He suggested we purchase the same software that H.Y.I.P. scammers use .... for just over $100 ONLY !!!! It was the office joke for a while, but in the end he was RIGHT - it was much cheaper and much quicker. All he did was to manipulate certain functions and features to suit our Group's needs .... and PRESTO !!!!! [5]

17. P-2-P's website also promised that P-2-P would pay referral commissions.

> [Y]ou will want to tell all your friends and we do offer handsome referral commissions for the term that they invest in the plan

The website represented that the commission would be paid when the person referred made their investment through their P-2-P account.[6]

Payment processors

18. I determined through a local investor that he had paid for his investment through International Payout Solutions ("IPS"), a payment processor located in Florida. We subpoened

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[5] Professor Byrne's had the following observations about the quoted passage:

> "The cynicism of the drafters of these materials shows in their tongue in cheek statement that their 'programmers' recommend the use of 'H.Y.I.P.' 'Software.' Even if there was such software, the underlying 'joke' was that the same software would have worked because the P2P program was just another high yield scam."

Byrne Declaration at paragraph 40.

[6] According to E.M., it appears that the amount of the commission paid was ten percent of the investment. E.M. was SMIRNOW'S co-conspirator and is discussed below.

records pertaining to P-2-P from IPS and obtained a list of P-2-P investors who had made investments in P-2-P through IPS.

19. IPS records show that the principal of P-2-P was **NICHOLAS SMIRNOW**. **SMIRNOW** submitted a copy of his Canadian Passport and Ontario Driver's license as proof of identity in order to establish a business relationship with IPS. In addition, IPS also communicated with **SMIRNOW** by email.

20. In reviewing P-2-P's website, including their member's forum, I was able to determine that P-2-P also used two Canadian payment processors, Alert Pay ("AP") and Solid Trust Pay ("STP").

21. I obtained some records from Alert Pay, located in Canada. Alert Pay also identified **SMIRNOW** as the principal of P-2-P based upon identification documents submitted by **SMIRNOW** in order to establish an account with Alert Pay.

22. I did not speak to the third payment processor, Solid Trust Pay. STP was interviewed by the Anti Rackets Section of the Ontario Provincial Police. ("OPP"). The OPP advised your affiant that STP also identified **SMIRNOW** as P-2-P's principal, based upon identification documents submitted by **SMIRNOW** and communications between the two.

How investors made their investment

23. After obtaining a list of P-2-P investors from IPS, I started contacting them by email and by telephone. The Postal Inspection Service sent emails to all of the P-2-P investors identified by IPS and received responses from hundreds of them, through email, U.S. Mail, and

by telephone. In turn, I followed up investors' email responses with telephone calls. I spoke to hundreds of investors. Many investors printed out pages from P-2-P's website and sent me these screen shots. These printed screen shots show the date on which they were printed..[7]

24. Based upon my review of P-2-P's website, records I obtained from International Payout Solutions and Alert Pay, conversations I had with IPS and AP, information related to STP obtained by the Ontario Provincial Police, interviews of investors, and the review of records pertaining to financial transactions with the payment processors and P-2-P, I am familiar with the mechanism P-2-P utilized to funnel money from investors. P-2-P's website provided an interactive mechanism for investors to establish their "account" with P-2-P and make investments in various P-2-P programs. After investors established their account on P-2-P's website, investors would deposit funds with the payment processor and transfer the money to P-2-P's account with that payment processor, whereupon the money transferred would eventually show up in the investors' P-2-P account. The P-2-P website allowed the investor to log on to their "account" and make an investment in P-2-P from the money transferred from the payment processor. The website also purportedly allowed investors to transfer account balances to their payment processor accounts for withdrawal or distribution.

25. P-2-P used STP and AP from the inception of the scheme until the creation of P-2-P Energy, Limited. The funding and payment mechanisms for all three processors were essentially the same.

26. Sometime in mid 2008, it appears that **SMIRNOW** began the process of creating

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[7] A review of the P-2-P web pages printed by investors and provided to the government confirms the accuracy of the web pages archived in Internet Archive.

his own in house payment processor, P-2P Energy, Ltd. ("P-2PE"). There are postings to the P-2-P private forum on P-2-P's website in mid 2008 that indicate that **SMIRNOW** was in the process of creating P-2PE.[8] Based upon a review of records provided by IPS, by SunTrust Bank, and discussions with IPS's principals, I learned that P-2P Energy, Ltd. contracted with IPS to process all P-2P Energy, Ltd transactions through SunTrust Bank in Florida. Thereafter, P-2 P Energy, Ltd took the place of STP and AP. Records supplied by IPS and by SunTrust Bank also show that IPS set up bank accounts for P-2-P and TMI Group, SA to receive and send money.[9]

27. P-2 P Energy, Ltd, was a company incorporated under the laws of the Turks & Caicos Islands, according to documents provided by **SMIRNOW** to IPS and obtained by the government. The records show that **SMIRNOW** was one of two directors and shareholders of the company. The other shareholder was M&S Nominees, Ltd and the other shareholder was M&S Directors, Ltd. Since the company performing the incorporation services for **SMIRNOW** was M&S Trust Company, Limited, there is reason to believe that the other corporate director and shareholder in P-2PE were nominees of **SMIRNOW** and hence that **SMIRNOW** was in effect the sole shareholder and director. The cover letter enclosing these and other documents pertaining to the formation of P-2 P Energy Ltd were sent to **SMIRNOW** on March 26, 2008 at

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[8] Affiant received printouts of the a P-2-P Private Forum on August 13, 2008 from several investors. That posting discusses the creation of P-2-P Energy Limited which the posting refers to as an "offshore" entity. In another P-2-P Private Forum printout dated August 28, 2008 the posting refers to a conversation with "Nick" and the fact that the opening of P-2-P Energy was "two weeks away."

[9] TMI Group, SA ("TMI") did business as TruMar Invest & TruMar Holdings. TMI was owned by E.M., Smirnow's co-conspirator. It is discussed more fully below

an address in Baysville, Ontario, Canada and not to an address in the Turks & Caicos Islands.[10]

Netherlands investigation

28. The web based application that was used by P-2-P was developed by Michiel Bakker from the Netherlands. At the request of the U.S. Attorney's Office, Michiel Bakker was interviewed by the Rotterdam-Rijnmond Regional Police in Rotterdam which provided a Verbal Process of the interview.[11] According to the Verbal Process, Mr. Bakker provided the following information:

A. His first contact with **SMIRNOW** was in early 2007, when **SMIRNOW** expressed interest in obtaining a web based financial software application Bakker had developed which was sold under the name Sysinvest and Sysinvest Pro. Bakker had contact with **SMIRNOW** by telephone on several occasions, and by email, but they never met in person.

B. It was Bakker's understanding that **SMIRNOW**'s company was Dianic

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[10] Counsel for the government provided to the U.S. Postal Inspection Service a copy of the Turks and Caicos Islands Companies Ordinance 1981 obtained from the web site of the Turks & Caicos Islands Financial Service Commission, www.tcifsc.tc/legislation.htm. Section 183 of the Ordinance provides that:

> " A proposed exempted company applying for registration as an exempted company shall submit to the Registrar a declaration signed by a subscriber to the effect that the operation of the proposed company will be conducted mainly outside the Islands."

There were claims in P-2-P's member forum (part of P-2-P's website) that P-2-P operated, not from Canada, but from the Turks & Caicos Islands. Such a claim could not lawfully be based upon P-2PE's charter since it appears that the law precludes operating an Exempt company mainly from the Turks & Caicos Islands.

[11] The Verbal Process is like a memorandum of interview. The document was provided in Dutch and the Postal Inspection Service arranged the translation into English.

Holdings International based in the Turks and Caicos Islands and that Pathway to Prosperity was a subsidiary of Dianic.

C. **SMIRNOW** paid to use Sysinvest and used the application online for Pathway to Prosperity.

D. Sometime in mid 2007, **SMIRNOW** informed Bakker that he planned to set up his own Internet bank. **SMIRNOW** did not want to continue to pay fees to other Internet banks.[12] **SMIRNOW** asked Bakker if he would be interested in developing sofware to be able to start an online bank and Bakker began to develop the software.

E. Toward the end of 2007, **SMIRNOW** told him that International Payout Systems already had an online banking system that **SMIRNOW** wanted to start using. The system was on IPS's servers but a link had to be established with P2P's online application. Bakker established the necessary link.

29. Bakker described how Sysinvest worked with respect to P-2-P, using Alert Pay as an example of the payment processor:

A. A customer sets up an account on the P-2-P website. The customer creates his own user name and access code.

B. The customer creates an account with Alert Pay and then deposits money into his Alert Pay account.

C. The customer transfers money from his Alert Pay account to P-2-P's Alert Pay account. This amount is (automatically) added to the customer's P-2-P account. When the

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[12] Bakker appears to be referring to what I have described as "payment processors," like Solid Trust Pay and Alert Pay.

money was thus added to the customer's P-2-P account, the money went directly into **SMIRNOW'S** on-line bank account. Once the money went into **SMIRNOW**'s bank account, it was impossible for the consumer to transfer the money back himself.

D. For a customer to withdraw money from their P-2-P account, the customer had to submit to P-2-P a request for payment. While the depositing of money was automated, the *withdrawal* of money was not. To withdraw money, a customer had to get P-2-P to place an order for the withdrawal with P-2-P's internet bank.

E. A formula could be inputted into the Sysinvest software. By way of example, if a customer were to invest $1,000 with P-2-P, with the inputting of a particular formula, the customer would be able to see daily, weekly or monthly how much "profit" the investor had received on their $1,000 investment.

F. The application also allowed the investor to see how much money was in their P-2-P account. However, the money that was displayed in the investor's online P-2-P account was actually in **SMIRNOW**'s online bank account.

30. Bakker had contact with E.M., who performed customer support on P-2-P's behalf. Bakker did not otherwise know what E.M.'s role was in P-2-P. E.M. informed Bakker that Tru-Mar invested the money that it received through its own internet site with P-2-P.

31. Bakker was told by **SMIRNOW** that P-2-P's money was invested in casinos and real estate.

Ontario Investigation

32. The Ontario Provincial Police ("OPP") has been conducting a concurrent

investigation of P-2-P. I have been advised by the OPP that they conducted a search of the residence of **SMIRNOW** in January, 2009. A request to Canada for the production of the records obtained during the search is pending.[13]

33. I was advised by the OPP that they interviewed one of **SMINROW's** former employees ("D.C."). The OPP advised me that D.C. stated as follows:

A. When he first met **SMIRNOW**, D.C. was a taxi cab driver in Huntsville, Ontario. **SMIRNOW** did not own a car and D.C. drove **SMIRNOW** and his wife when they needed transportation. He drove **SMIRNOW** until sometime around June or July, 2007, when **SMIRNOW** bought a used Chrysler Concorde.

B. In September, 2007 D.C. and his wife began working for **SMIRNOW**. **SMIRNOW** had been operating P-2-P from his rented home. D.C. and his wife handled the back office, answered the phone, managed investor accounts and answered questions from investors.

C. Approximately a year into the operation of P-2-P, **SMIRNOW** expressed satisfaction that P-2-P had survived its first birthday. **SMIRNOW** explained that ventures such as P-2-P seldom survived the first year.

D. **SMIRNOW** had approximately 25,000 investors as of May, 2008, and

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[13] Canada and the United States entered into a Mutual Legal Assistance Treaty ("MLAT") in which both parties agreed to provide evidence to the other in criminal investigations. An "MLAT" request was submitted by the Office of International Affairs of the U.S. Department of Justice to the International Assistance Group of the Department of Justice Canada on January 13, 2010. While the Ontario Provincial Police has provided some materials to the United States Postal Inspection Service informally, as it is permitted to do under Section 3(2) of the Canadian Mutual Legal Assistance in Criminal Matters Act, the government is awaiting the production of the balance of the investigation materials by Canada.

SMIRNOW during the time D.C. worked for **SMIRNOW**, only paid returns to the investors he liked.. Of P-2-P's 25,000 investors, D.C. characterized only 5,000 of them as "happy." The majority of investors were upset because they weren't getting their returns as promised.

E. **SMIRNOW** purchased a home in Baysville, Ontario, for approximately $315,000. **SMIRNOW** told D.C. that a substantial amount of P-2-P investor funds kept in STP were used to purchase the home.

F. **SMIRNOW** made many trips to the Turks & Caicos Islands with the goal of purchasing a condominium there. **SMRINOW** also opened off shore bank accounts in the Turks & Caicos Islands.

G. D.C. and his wife worked for P-2-P and **SMIRNOW** until May, 2008, when they left because they realized what P-2-P was doing was wrong. When D.C. left, investors had been complaining about not getting their money back.

Professor James E. Byrne

34. The government consulted Professor James E. Byrne, Associate Professor of Law, George Mason University, who has been an expert witness for both the Federal Reserve and the U.S. Securities Exchange Commission in the area of High Yield Investment Programs. For more than 25 years, Professor Byrne has served in various positions of leadership and responsibility in the field of international banking operations, as is more particularly described in his Declaration. Among his leadership positions in this area was as Chair of the Group of Experts on Commercial Fraud of the Secretariat of the United Nations Commission on International Trade Law ("UNCITRAL"), Co-Chair of the UNCITRAL Symposium on International Commercial Fraud,

and Co-Chair of the North American and European Standing Committees on Combating Commercial Fraud.[14]

35. Professor Byrne was asked to review the web pages of P-2-P obtained from investors and the Internet Archive and then render an opinion concerning the investment program which the web pages described. His opinion is set forth in his written declaration.

36. While Professor Byrne did not perform a quantitative analysis of the specific claimed rates of return, he observed that in the legitimate finance world, investments that produce higher rates of return generally have greater perceived risks. Professor Byrne also labeled P-2-P's claimed rates of return as "extraordinary."

> [T]he feature most characteristic of a high yield scam is the disproportion between the supposed returns and the perceived risk. That feature alone would identify the scheme described in the materials that I have reviewed as fraudulent.[15]

37. Taken as a whole, it was Professor Byrne's opinion that the program described in the reviewed materials most closely resembled a scam known as a high yield investment program. The programs promise rates of return not achievable on a sustained basis in the real world and obscure the means by which these returns are achieved.

38. Professor Byrne summarized his opinion as follows:

> In my considered professional opinion, the investment scheme described in the materials that I have reviewed are not legitimate but resemble and are classic instances of so-called high yield frauds and fraudulent pyramid schemes. The proposed returns are excessive for even the most risky legitimate investments and are simply preposterous for investments whose principal is supposedly

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[14] Professor Byrne's qualifications are set forth in paragraphs 6 through 13 of his Declaration.

[15] Byrne Declaration at paragraph 30.

guaranteed. In addition, the materials contain other features common to commercial frauds including an element of a pyramid scheme and, if there were payouts, it is my opinion that it is highly likely that they were derived from the investment of the same or other victims, making the scheme also a ponzi scheme. It is apparent to me that the materials and the scheme which they describe were deliberately and artfully constructed, drawing on similar scams to deceive, confuse, entice and trap would-be investors.[16]

Professor Todd T. Milbourne

39. The government consulted Professor Todd T. Milbourne, the Hubert C. and Dorothy R. Moog Professor of Finance at the Olin Business School at Washington University in St. Louis. Professor Milbourne has been on the Olin faculty since August 2000. He teaches both at the Danforth Campus in St. Louis and at Olin's Executive MBA program in Shanghai, China. Prior to joining Washington University, Professor Milbourne was on the full time faculty at the London Business School from 1996 to 1999. In 1999-2000, he was a Visiting Assistant Professor of Finance at the University of Chicago.[17]

40. Professor Milbourne holds a Doctor in Philosophy degree from Indiana University in Business (Finance) which he received in 1995. His doctoral studies specialized in the area of financial economics. He has a Bachelor of Arts degree *magna cum laude* from Augustana College which he received in 1991. His undergraduate majors were Business Administration (Finance), Economics and Mathematics, with a minor in Computer Science. He is a member of Phi Beta Kappa.

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[16] Byrne Declaration at paragraph 14.

[17] Professor Milbourne's qualifications is set forth in paragraphs 6 through 12 of his Declaration. His Declaration is referred to as the "Milbourne Declaration."

41. For more than 16 years, Professor Milbourne has lectured and taught courses in the areas of finance, investments, corporate financial management, financial performance measurement and financial markets to bankers, asset managers, consultants, lawyers, and business people in more than eight countries throughout the world. He has presented the findings of his own research on finance, financial markets, performance measurement, executive compensation and corporate finance to academics, business people, bankers and consultants in over 14 countries throughout the world.

42. Professor Milbourne has co-written a book on Corporate Finance that is in its fourth edition. He has also published over 18 research articles in the area of corporate finance.

43. Professor Milbourne has been a Member of the Standard & Poor's Academic Council since 2004. He also was a Fellow at the Center for Financial Research at the Federal Deposit Insurance Corporation from 2004 to 2005.

44. Professor Milbourne reviewed the claims made by P-2-P on its website and prepared a Declaration which summarizes his opinion. It is appended hereto as Attachment B ("Milbourne Declaration"). He concludes as follows:

> It is my professional opinion that the investment returns described in the P2P materials that I have reviewed are wholly inconsistent with any investment returns that have been earned historically in domestic (U.S.A) or global financial markets. I can find no such evidence of legitimate investment strategies that historically would have delivered even a modest fraction of the purported investment returns of P2P. In addition, I can find no such evidence to support the claims of P2P to guarantee their investment plans.
>
> My conclusion is that the returns purported in the P2P website materials are grossly exaggerated and seemingly outrageous given the investment returns that can be documented from legitimate and documented investment strategies over

time. [18]

45. Professor Milbourne took P-2-P's claimed rates of return for its 7, 15, 30 and 60 day programs and calculated an annual rate of return. For purposes of one of his calculations, he assumed that investors would withdraw all of their "profits" when each plan matured and reinvest *only the principal* (over a year's period). Using that approach, P-2-P was representing that a 7 day plan produced an annual return of 546%, a 15 day plan produced an annual return of 630%, a 30 day plan produced an annual return of 720% and a 60 day plan produced an annual return of 900%. However, for those investors who reinvested their principal and promised interest as each plan completed, at the end of a 7, 15, 30 or 60 day program, then supposedly a 7 day plan would deliver an annual rate of ***over 17,000 %*** and a 15, 30 and 60 day program would result in annualized returns ***in excess of 20,000 percent.*** [19]

46. From the years 1928 through 2009, the average return to stockholders in the Standard & Poor's 500 was 11.3%.[20] The single highest annual return during the entire life of the S&P 500 index was 52.6%.[21] Therefore, even if you "cherry pick" annual returns by picking the best year *ever*, P-2-P's promised returns are over ten times *higher*.

47. According to Professor Milbourne, Warren Buffett, Chairman and CEO of Berkshire Hathaway, is considered one of the best investment managers there is. His nickname

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[18] Milbourne Declaration at paragraphs 48 and 49.

[19] Milbourne Declaration at paragraphs 14-18.

[20] *Id.* at paragraph 22.

[21] Milbourne Declaration at Exhibit C.

is the "Oracle of Omaha." Between 1977 and 2009, the average return to stockholders of Berkshire Hathaway was 27.3%, more than *double* the average return of the S&P 500.[22] However, Warren Buffet's performance pales in comparison with the supposed financial acumen of **SMIRNOW** who claimed to be capable of achieving annual returns exceeding 500% in all four of his plans, more than twenty times better than the performance of one of the best performing money managers in the world.

48. Some professional mutual fund managers have been able to outperform the market. However, according to Professor Milbourne, historical data suggests that when a manager is able to outperform the market, it is by only a relatively modest amount.[23]

49. Professor Milbourne identified papers on insider training that were published in scholarly journals which identifies financial returns that have been achieved through insider trading.[24] In one study of insider trading cases brought by the Securities and Exchange Commission between 1980 to 1989, the height of the insider trading scandals, examining the amount of illegal return from a sample of 183 cases, these insiders were able to achieve a return of approximately thirty percent over a two week period. While this rate of return is roughly equal to what P-2-P promised on a fifteen day program, according to Professor Milbourne, "there is no rational basis for suggesting that the insider could repeat this feat 24 consecutive times as is

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[22] Berkshire Hathaway and Warren Buffett are described in the Milbourne Declaration at paragraph 24.

[23] *Id* at paragraphs 34-39.

[24] *Id* at paragraph 46-47.

purported by P2P in their 15-Day Plan."[25] In other words, while it is possible for investors to achieve very substantial short term profits as a result of illegally trading based upon undisclosed, non public information, it is not rational to suppose that this return is achievable every two weeks for the period of a year, even illegally. Professor Milbourne therefore concluded that "the ability of an investor to earn the rates of return promised by P2P cannot be justified even on the basis of illegal insider trading."[26]

50. Therefore, I read Professor Milbourne's Declaration to mean that the returns represented by **SMIRNOW** were essentially unachievable by legitimate means and hence that **SMIRNOW** would have had no objective basis to believe that his representations could be accurate. I also read his opinion to mean that there was no objective basis for **SMIRNOW** to believe that his represented rate of return was achievable even through investments made *illegally,* like, for instance, illegally trading on inside information.

Lack of legitimate investments by P-2-P

51. The government has obtained some financial records from Solid Trust Pay, Alert Pay and International Payout Solutions. Solid Trust Pay and Alert Pay were the two Canadian payment processors used by P-2-P. International Payout Systems, which was located in Florida, provided the infrastructure necessary for P-2P Energy, Ltd. to operate. Solid Trust Pay and International Payout Systems provided spread sheets which identify deposits and withdrawals from the accounts of P-2-P and P-2-P's customers. Alert Pay, which is beyond the reach of the

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[25] *Id* at paragraph 47.

[26] *Id.*

U.S. government's subpoena power, voluntarily provided records of deposits and withdrawals, but did not provide sufficient information from which the identity of the person or entity making the deposit or withdrawal could be ascertained.

52. Based upon my review of these records, it appears as if approximately three quarters of all investor funds flowed through STP. Approximately eighteen percent flowed through AP and the remainder, approximately seven percent flowed through IPS and P-2PE.

53. STP's records show that approximately 2,500 of 20,000 investors received a net profit. Approximately 150 investors broke even and the remainder had individual net losses ranging up to $60,640.

54. STP's records further show that approximately $53 million was deposited into the STP account for P-2-P and approximately $48 million was transferred out. I analyzed STP's records to determine who the largest payees were. I theorized that if P-2-P were legitimate and making legitimate investments as claimed, then there should be evidence of large expenditures of P-2-P investment funds to fund managers, financial institutions, investment banks, or other similar institutions. If such legitimate investments had been made, I further theorized that there should be evidence of these investments in the records of Solid Trust Pay, a payment processor that took in three quarters of P-2-P's funds.

55. Given the amount of money raised by P-2-P, I would have expected to find very large transfers of funds to some financial institution, financial services firm or institutional professional, if P-2-P were legitimately making investments. To conduct my analysis, I identified the largest payees. I found only eleven payees which received more than $200,000. Only two of the eleven top payees received more than a million dollars and only three of the

eleven received more than $500,000.

56. I then attempted to determine whether it was reasonably likely that any of these top eleven payees could have been conduits for legitimate investments by P-2-P. Of the top eleven payees, I have been currently able to research or interview seven of them.

57. The largest payee of the top eleven was Tru-Mar Holdings which received $2,117,752.50. Tru-Mar Invest and Tru-Mar Holdings were names under which TMI Group, SA ("Tru-Mar") operated. According to documents submitted by Tru-Mar to IPS, the principal of TMI Group, SA was E.M. E.M confirmed that she was the principal of Tru-Mar when she was interviewed at her home in Pennsylvania the day a search warrant was executed there by U.S. Postal Inspectors. IPS's records show that **SMIRNOW** designated E.M. to be an agent of P-2-P with authority to act on **SMIRNOW**'S behalf. While she confirmed that she received the $2,117,752.50 in P-2-P's funds as shown by STP's records, she admitted that none of it was for investment on behalf of P-2-P. Most of it funded Ponzi payments made to Tru-Mar's own investors. She admitted that Tru-Mar made no legitimate investments with the funds she received from **SMIRNOW** and also made no legitimate investments on behalf of Tru-Mar.

58. The second largest payee was a company in Sweden which I will refer to as "SV Holdings." SV Holdings received a $1,044,084.17 return, netting out its original investment. SV Holdings also runs what appears to be a High Yield Investment Program at a website with a Swedish domain (.se). I examined the website and learned that the principal of SV Holdings is one S.V., who according to the website operates a business providing ventilation system maintenance in Sweden. It transmitted $168,000 to P-2-P and received $1,044,084.17 net in return. I also noted that there are several hundred P-2-P account holders in Sweden. While I

cannot totally exclude the possibility that the SV Holdings received over a million dollars to make legitimate investments on behalf of P-2-P, the circumstances suggest that SV Holdings was a shill for P-2-P and that the money received in return for the $168,000 was likely a combination of referral fees from the investment of Swedish investors recruited into the scheme by SV Holdings and Ponzi payments it received linked to its own investments. It does not appear that the million dollar payment to SV Holdings was for the purposes of having SV Holdings make investments on P-2-P's behalf.

59. The third largest payee is a company owned by someone I will refer to as "K.B." K.B. received over $500,000 from P-2-P. K.B. was the owner of a web site that touts high yield investment programs. From the nature of K.B.'s business, it does not appear likely that P-2-P funneled $500,000 to K.B. to make legitimate investments on P-2-P's behalf.

60. The fourth, fifth, and eight recipients of the largest payments from P-2-P's account with STP are CWM from Oregon, JP from Florida, and CM of Washington State.. They received $425,522.11, $327,150.58 and $285,185.24 net respectively. Affiant interviewed all three who indicated that they were investors in P-2-P and that these sums represented purported P-2-P earnings. All of them indicated that the funds were not received by them to make legitimate investments on P-2-P's behalf.

61. Affiant has been unable to either locate or contact the additional four payees who received over $200,000 in profits, and who rank sixth, ninth, tenth and eleventh by dollar amount. However, having been able to account for seven of the eleven largest recipients of P-2-P funds, and the five largest, and having been able to conclude that it is unlikely that any of these seven were recipients of P-2-P funds for the purpose of making further legitimate investments on

P-2-P's behalf, it appears that at least with respect to seventy five percent of P-2-P's total investment, there is little, if any, legitimate investment. Even if I were to assume that *all* of the investors' funds which were funneled to **SMIRNOW** through the other major payment processor, Alert Pay, were legitimately invested, I would still have to conclude that P-2-P was a Ponzi scheme, based upon what I observed with deposits and withdrawals through STP's account.

62. In an attempt to confirm the soundness of my approach to analyzing the records of STP's to determine whether they are consistent with or inconsistent with P-2-P being a legitimate investment company, I consulted with an attorney who formerly worked for the U.S. Securities & Exchange Commission as an enforcement attorney and who currently works both in private practice and serves as a part time hearing officer for the Illinois Securities Department. It was his view that if the financial records showed large wire transfers or checks to underwriters, brokerage houses, fund managers, financial institutions, real estate developers, or similar institutional entities, and large transfers back to the investment company from those institutions, that the pattern of transactions so described would be consistent with a company that was making legitimate investments. If, on the other hand, what I observed were large expenditures to individuals and not financial institutions and similar business organizations, not in large blocks relative to the total amount of investment, but in relatively smaller amounts, that would be inconsistent with an investment company making legitimate investments and would be consistent with the entity being a Ponzi scheme. I concluded from my conversation with this securities law expert that my judgement was correct that STP's records tended to show that P-2-P resembled less a legitimate investment company and more like a Ponzi scheme.

Southern District of Illinois Investors

63. I interviewed the investors in the Southern District of Illinois who are referred to in the Counts of the complaint. Each of them lost their investment in P-2-P.

64. B.F. is a resident of Franklin County, within the Southern District of Illinois. B.F. provided the following information:

A. She was introduced to P-2-P in June or July of 2008 by a friend. After reading the information on P-2-P's web sites promising large returns on her investment, she decided to make an investment in P-2-P

B. On July 31, 2008 she purchased a Postal Money Order for $210.00 payable to Alert Pay and sent the Postal Money Order by first class U.S. Mail to Alert Pay, Inc, 5200 De La Savane, Suite 220, Montreal, Canada. A copy of the Postal Money Order receipt was provided by B.F. to affiant.

C. On or about August 9, 2008, she transferred $200 from her AlertPay account to P-2-P's Alert Pay account and invested the money into a 60 day plan which advertised a 160% return over 60 days plus a return of her principal.

D. On the same day she accessed her account information on P-2-P's interactive web site and the web page displayed her investment in P-2-P's 60 day plan and the advertised rate of return. The web page showed that her 60 day plan was to be complete on October 8, 2008. A printout of this web page was provided to affiant.

E. When the October 8, 2008 completion date arrived, and she purportedly had achieved her 160% return as promised, she decided to reinvest the funds.

F. P-2-P's web site eventually went down and she was no longer able to access her account. To this day she has never received any return on her investment and has also never received a return of the principal.

65. C.T.D. is a resident of Jackson County, within the Southern District of Illinois. C.T.D. provided the following information:

A. He was introduced to P-2-P in the summer of 2007 by a friend. Initially, he did not decide to invest. About one year later, on or about August 19, 2008, he was re-contacted by the friend, persuaded to invest, and provided information as to how to make an investment in P-2-P.

B. Prior to making his initial investment, he reviewed P-2-P's website which represented that a P-2-P investment would produce a very high rate of return and was guaranteed. He also contacted another friend who had invested in P-2-P and was told that he had received a payout from P-2-P and believed that P-2-P was legitimate

C. On or about August 29, 2008, he sent $500.00 by check to Solid Trust Pay, P.O. Box 551, Bobcavgeon, Ontario, Canada. He used a U.S. Postal Service Priority Mail envelope and sent the check by means of the U.S. Postal Service. He initially invested in the 30 day plan.

D. On or about October 1, 2008, at the end of the 30 day plan, he accessed his P-2-P account on line and requested a withdrawal of his purported earnings which P-2-P's website indicated had accrued to his account. According to the information on the website, his withdrawal was placed into a "pending" status.

E. On October 1, 2008, having seen his P-2-P account information on P-2-P's website purporting to show that his investment had achieved the promise return, he purchased a cashier's check for $24,501.00 payable to Solid Trust Pay. He sent the cashier's check by Priority Mail through the U.S. Postal Service to Sold Trust Pay at their post office box in Babcaygen, Canada.

F. On or about October 3, 2008, the cashier's check was deposited into his Solid Trust Pay account and through Solid Trust Pay's website he transferred $24,500 to P-2-P's Solid Trust Pay account.

G. The same day, through P-2-P's interactive website, he accessed his P-2-P account and invested $24,500 in a 30 day plan.

H. At the maturity of his 30 day investment, he requested a withdrawal of his earnings. According to P-2-P's website, the request was listed as "pending."

I. By sometime around January 2009, he was unable to log onto his account on P-2-P's website.

J. To this day, he has been unable to withdraw either his earning or his principal.

66. D.W. is a resident of Williamson County, within the Southern District of Illinois. D.W. provided the following information:

A. She was introduced to P-2-P through a friend who told her that P-2-P was a good way to prepare for retirement. Her friend told her that once she made her investment with P-2-P that it would substantially increase in value.

B. Because the promised rate of return seemed to be very good based upon her own review of P-2-P's web site, she decided to make an investment in P-2-P. On or about September 20, 2008, in order to establish an account with Solid Trust Pay, she faxed copies of identification documents to Solid Trust pay at 705-738-9068. (Area Code 705 is in Ontario, Canada). She provided copies of the fax to affiant.

C. About three days later, on September 23, 2008, she purchased a cashier's check for $5,001.00 at Banterra Bank in Marion, Illinois. The check was payable to Solid Trust Pay and she used United Parcel Service, an interstate commercial courier, to send the check from Marion, Illinois, to Ontario, Canada. Two days later, on September 25, 2008, the check was deposited into her STP account. She provided a copy of the UPS receipt to affiant.

D. On or about September 27, 2008, she transferred $5,000 from her STP account to the STP account used by P-2-P. The funds were transferred based on the instructions provided on the P-2-P website for an investments in P-2-P.

E. On the same day, on P-2-P's website, and from the P-2-P account she had established on line, she invested $5,000 into a 60 day plan. The investment was made in reliance upon the information she reviewed on P-2-P's website, including the "FAQ," regarding the represented rate of return for a 60 day plan and the representation that there was a guaranty. She printed off and kept the FAQ section of the website she had reviewed and relied upon and provided a copy to affiant.

F. When the 60 day program was completed, she decided to reinvest her purported earnings and the principal. She intended to keep reinvesting until March or April, 2009, when she planned on withdrawing the funds.

G. On or about February 2, 2009, she accessed her account on P-2-P's website and her account balance was $25,000.

H. To date she has been unable to withdraw either her principal or her earnings.

67. V.D. is a resident of Madison County, within the Southern District of Illinois. I interviewed V.D. and she provided the following information:

A. Sometime in August, 2008, she was introduced to P-2-P by her brother. Her brother, who had reviewed P-2-P's website and had made an investment, told her that P-2-P was making money for him and therefore recommended that she invest.

B. On or about October 24, 2008, she established an account with P-2-P.

C. Shortly thereafter, on or about October 27, 2008, she requested a wire transfer from her bank account at Bank of America in Edwardsville, Illinois in the amount of $1,071.90 to an International Payout Systems, Inc bank account at SunTrust Bank, Atlanta, Georgia. The funds were to be credited to P-2-P Energy, Ltd. She provided a copy of the wire transfer receipt to affiant.

D. On October 28, 2008 she received an email confirmation that her funds had been received and was advised that she could log on to her account at https://fin.p-2-penergyltd.com. She provided a copy of the email to affiant.

E. On October 29, 2008, she logged on to her P-2-P Energy, Ltd account through International Payout Systems in accordance with the email instructions and invested $1,000 in a 60 day investment plan. The plan was represented to return 160.2% plus the principal in 60 days. She made her investment in reliance on the returns her brother told her she would received based both upon his review of P-2-P's website and the apparent success of his P-2-P investment.

F. The plan was scheduled to complete on December 28, 2008. The day after her investment supposedly completed, on December 29, 2008, she then re-invested her apparent earnings plus the principal in another 60 day program.

G, After her second 60 day program had completed, she was unable to either withdraw or reinvest her money. She provided affiant with a print out of her account information from P-2-P's web site

H. To this day she has received neither her principal nor any earnings on her P-2-P investment.

68. L.D. is a resident of Madison County, within the Southern District of Illinois. L.D. provided the following information:

A. L.D. is the son of V.D. He was introduced to P-2-P through her uncle and mother. In December, 2008, based upon a review of P-2-P's website and the online account history of the returns produced in her uncle and mother's accounts, he decided to put his own money into P-2-P.

B. On December 4, 2008, at the Bank of America branch in Edwardsville, Illinois, he requested a wire transfer of $3,035.95 to Sun Trust, to the account of P-2-P Energy, Ltd, as he was instructed to do an email I received from support@p-2-penergyltd.com. He provided both a copy of the wire transfer form and the email instructions to affiant.

C. The funds so transferred to P-2-P Energy, Ltd were to have been available for investment in his P-2-P Account. The roughly $3,000 he wire transferred, however, never appeared in her P-2-P account.

D. After approximately four to five months her funds had still never been transferred from P-2-P Energy Ltd into his P-2-P account and his web account became inaccessible. To this day he has received neither a return on his investment nor a return of his investment.

69. I spoke to hundreds of P-2-P investors who also invested with the expectation that they were to receive extraordinary returns on their investment, but who lost substantial sums of money. The investors I spoke with relied on the representations on the P-2-P websites, either directly or indirectly. Most personally read the websites. Those that didn't generally relied upon a friend or relative who read the website and who received a return on their investment, a return which for reasons described elsewhere in this affidavit, appear to be Ponzi payments. Hundreds sent me copies of printouts they had made of P-2-P's website, postings that had been made on the P-2-P's members forum, and internet sites touting high yield investment programs which contained postings related to P-2-P. I reviewed the material provided by various P-2-P investors and it is consistent with the web pages described above which I accessed through Internet Archive. Representations about the rate of return and the existence of a guarantee appear to have been made from the beginning of the scheme and remained consistent throughout its life.

Smirnow's Criminal Record

70. In the FAQ section of P-2-P's website the question is posed "[w]hy is your identity hidden?" The answer given included the following:

> We do not expose ourselves to possible harm/risk resulting from people, companies or organizations who do not share the strong moral foundations we do.
>
> * * *
>
> The internet may be a wonderful place, but it has attracted the bad element of our

society too.

71. Your affiant read these statements as at least indirect assertions that the principal of P-2-P, **NICHOLAS SMIRNOW**, was a person with a "strong moral foundation" and *not* part of the "bad element of our society."

72. By making assertions about his purported moral character on a public internet site intended to induce investors to send him substantial sums of money, **SMIRNOW** made his moral character part of an investor's decision making process and hence relevant and qualitatively material.

73. Affiant was advised by Canadian law enforcement authorities that **SMIRNOW** had been convicted of serious crimes in Canada. Among these convictions are the following:

A. A 2002 conviction for the crime of breaking and entering;

B. A 2001 conviction for the crime of robbery with a firearm;

C. A 1996 conviction for the crime of cultivation of a narcotic for purpose of trafficking;

D. A 1981 conviction for the crime of possession of stolen property; and

E. A 1979 conviction for the crime of trafficking in a controlled drug.

74. **SMIRNOW** admitted his criminal activity to his employee D.C. **SMIRNOW** admitted having gone to prison for robbery and characterized his involvement in that crime as being "the wheel man." **SMIRNOW** also admitted involvement in a double homicide in the Hamilton Niagara area of Ontario. He also claimed to have organized crime ties there.

75. In my opinion, a reasonable investor would likely have been misled by positive statements concerning **SMIRNOW'S** character, especially in light of the omission of

SMIRNOW'S substantial criminal activity.

Summary of Loss

76. Based upon my review of records obtained from payment processors, it appears that P-2-P had approximately 40,000 members. Some investors received returns substantially in excess of their investment. Because of the apparent lack of substantial legitimate investments by P-2-P with this money, I have concluded that the major source, if not the sole source, of the "profits" or "interest" received by these investors was the investments contributed by later investors. The vast majority received no returns on their investment and lost all of their money in P-2-P. Net losses to investors as a whole are approximately $70 million. The vast majority of P-2-P's 40,000 members lost their entire investment.

77. In reviewing records submitted by P-2-P to payment processors, I have found accounts set up by P-2-P investors from all of the permanently inhabited continents of the world. P-2-P account holders, when they registered for a P-2-P account, gave addresses in the following countries, *inter alia*: the United States, Canada, and Mexico in North America; Costa Rica, El Salvador, Honduras and Panama in Central America; Argentina, Bolivia, Brazil, Chile, Columbia, Equador, Guyana, Peru, Uruguay and Venezuela in South America; The Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Dominica, Dominican Republic, Grenada, Guadeloupe, Haiti, Jamaica, Martinique, Netherlands Antilles, Saint Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago in the Caribbean; Iceland, Norway, Sweden, Finland, Denmark, Iceland, the Faroe Islands, United Kingdom, Ireland, France, Belgium, Netherlands, Germany, Switzerland, Liechtenstein, Luxembourg,

Monaco, Andorra, Portugal, Spain, Malta, Italy, Austria, Hungary, Czech Republic, Slovakia, Slovenia, Romania, Bulgaria, Poland, Estonia, Latvia, Lithuania, Russian Federation, Belarus, Ukraine, Azerbaijan, Republic of Georgia, Greece, Macedonia, Croatia, Bosnia and Herzegovina, and Yugoslavia in Europe; Turkey, Cyprus, Armenia, Uzbekistan, Kazakhstan, Afghanistan, Pakistan, India, Republic of Maldives, Sri Lanka, Nepal, Cambodia, Thailand, Vietnam, Taiwan, South Korea, North Korea, Peoples Republic of China, Peoples Republic of China Hong Kong SAR, Singapore, Macau, Indonesia, Malaysia, Philippines, and Japan, in Asia.

78. I have also found investors in forty eight of fifty states, and eighteen of the thirty eight counties comprising the Southern District of Illinois.

Conclusion

79. I have concluded that P-2-P was a high yield investment scam. There does not appear to be any evidence of legitimate investments made by P-2-P and the substantial payments made to investors, particularly earlier investors, appear to be Ponzi payments. P-2-P promised investors exorbitant rates of return accompanied by assurances that their investment would be safe. **SMIRNOW**, however, had no objective basis to believe or assert that legitimate investments could produce the kind of returns on a sustained basis that he represented or implied that P-2-P was achieving.

80. This affidavit is intended to establish sufficient probable cause and does not set forth all of my knowledge about this matter.

81. For the reasons stated in this affidavit, *inter alia,* I therefore have probable cause to believe that **SMIRNOW** has committed the offenses of Conspiracy in violation of 18 U.S..C

§371, Mail Fraud in violation of 18 U.S.C. §1341, Wire Fraud in violation of 18 U.S.C. §1343, and Securities Fraud in violation of 15 U.S.C. §§77q(a) & 77x, in the manner set forth in the Criminal Complaint.

[redacted]

JACOB GHOLSON
Postal Inspector
United States Postal Inspection Service

STATE OF ILLINOIS)
) SS.
COUNTY OF ST. CLAIR)

Sworn to before me and subscribed in my presence on the 28th day of May, 2010, at East St. Louis, Illinois.

[redacted]

CLIFFORD J. PROUD
United States Magistrate Judge

A. COURTNEY COX
United States Attorney

[redacted]

BRUCE E. REPPERT
Assistant United States Attorney

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

DECLARATION OF PROFESSOR JAMES E. BYRNE

I, Professor James E. Byrne, declare under penalty of perjury pursuant to 28 U.S.C. Section 1746:

I. INTRODUCTORY STATEMENT

1. I have been requested by counsel for the United States (hereafter "US") to render my expert opinion in the above-styled litigation against Pathway to Prosperity Network or the P2P Network (hereafter "P2P") in connection with the request for seizure of assets and other related relief. Specifically, I have been asked to opine regarding the character, nature, viability, and legitimacy of the transactions that are the subject of this action and any resemblance that they may have to fraudulent financial investments.

2. I understand that it is my duty to express my expert opinion independently of any influence or advocacy.

3. In rendering my opinion, I have examined the documents indicated in Exhibit A. My opinion is subject to revision or amplification should further documentation or information be provided to me.

4. I have rendered my opinions in light of my experience, knowledge, research, and studies in the field of commercial transactions, banking operations, financial and payment systems and instruments, and commercial fraud.

5. My Declaration is organized in the following manner:

Attachment A

II. QUALIFICATIONS

6. For more than 25 years, I have served or do serve in various positions of leadership and responsibility in the field of international banking operations including:

- Chair and Reporter of the International Standby Practices Working Group (1994 - 1998) which drafted ISP98 (ICC Publication No. 590) and Secretary to the Council on International Standby Practices (ISP) (since 1998) which issues Official Comments on the ISP.
- Member of the Advisory Group to the International Chamber of Commerce (hereafter "ICC") Task Force that drafted UCP600 (2003 - 2007).
- Member of the U.S. Delegation to the Commission on Banking Technique and Practice of the ICC (since 1995).
- Chair of the Group of Experts summoned to advise the Secretariat of the United Nations Commission on International Trade Law (hereinafter "UNCITRAL") on the adoption and implementation of the United Nations Convention on Independent Guarantees and Standby Letters of Credit (since 2001).
- Head of the U.S. Delegation to the UNCITRAL Working Group on International Contract Practices which drafted the United Nations Convention on Standby Letters of Credit and Independent Bank Guarantees (1988 - 1995).
- Past Chair of the American Bar Association's Subcommittee on Letters of Credit (1996 - 2000); Vice Chair (1994 - 1996).
- Member of the following ICC Task Forces on the eUCP and the International Standard Banking Practice.
- Member of the US Delegation to the meetings of the Commission on Banking Technique and Practice of the ICC
- Advisor to the US National Conference of Commissioners on Uniform State Laws Drafting Committee on the Revision of UCC Article 5 (1990 - 1995).
- Director of the Institute of International Banking Law & Practice (since 1987).
- Editor of Letter of Credit Update (1985 - 1997) and of Documentary Credit World (since 1997), monthly journals of letter of credit and bank guarantee law and practice including related commercial frauds.

7. For more than 20 years, I have been involved in the following activities in connection with studying and combating commercial fraud:

- Chair of the Group of Experts on Commercial Fraud of the Secretariat of the United Nations Commission on International Trade Law (hereafter "UNCITRAL") (2002 to 2005).
- Co-Chair of the UNCITRAL Symposium on International Commercial Fraud (14 to 16 April 2004).
- Co-Chair of the North American and European Steering Committees on Combating Commercial Fraud (1999 - 2005).

- Advisor to the Secretariat of UNCITRAL on Commercial Fraud (2005 - 2008).
- At the request of the US Department of State, I have addressed the Plenary Session of UNCITRAL on its project on combating commercial fraud in 2002, 2003, and 2004.

8. Since I first became aware of the problem of commercial fraud in 1987, I have been consulted by the US Office of the Comptroller of the Currency, the US Securities and Exchange Commission, the Federal Bureau of Investigation, Scotland Yard, Standard & Poor's, the Commercial Crime Bureau of the ICC, various banks and corporations, and numerous individuals regarding commercial and financial fraud. In connection with this work, I have examined more than 1,500 sets of documents.

9. For more than 25 years, I have lectured and taught courses in the areas of letters of credit, international trade finance, and commercial fraud, to bankers, business people, lawyers, banks, corporations, and trade associations in more than 35 countries throughout the world.

10. In addition to the materials that I have reviewed, my opinions are based on my knowledge of standard international letter of credit and general commercial practice, and my research and studies regarding letters of credit and commercial fraud. My research and conclusions are regularly published and circulated in the letter of credit, financial, and commercial community and are subject to ongoing critical assessment. My qualifications and my publications are set forth in my resume which is attached as Exhibit B.

11. I have received the following degrees: L.L.M., University of Pennsylvania (1978); J.D., magna cum laude, Stetson University College of Law (May 1977); B.A., cum laude, University of Notre Dame (June 1968).

12. I have been a full-time faculty member at George Mason University School of Law since August 1982 where I teach subjects related to commercial law and practices including Commercial Paper, Letter of Credit Law, Contracts, Sales, Electronic Commerce, International Commercial Transactions, and Commercial Fraud.

13. I have given sworn written expert statements to courts in China, France, England, Singapore, South Korea, Switzerland, and the United Kingdom. I have been admitted as an expert on commercial fraud, banking operations, and standby letter of credit practice and given expert testimony in Canada, Hong Kong, Norway, and Thailand as well as in approximately 20 federal and 4 state courts in the United States.

III. SUMMARY OF OPINIONS

14. In my considered professional opinion, the investment scheme described in the materials that I have reviewed are not legitimate but resemble and are classic instances of so-called

high yield frauds and fraudulent pyramid schemes. The proposed returns are excessive for even the most risky legitimate investments and are simply preposterous for investments whose principal is supposedly guaranteed. In addition, the materials contain other features common to commercial frauds including an element of a pyramid scheme and, if there were payouts, it is my opinion that it is highly likely that they were derived from the investment of the same or other victims, making the scheme also a ponzi scheme. It is apparent to me that the materials and the scheme which they describe were deliberately and artfully constructed , drawing on similar scams to deceive, confuse, entice and trap would-be investors.

IV. EXPLANATION OF OPINIONS

A. The Transactions Reflected in the Materials

15. Cast in the form of an "investment club", the scheme described in the materials offer sustainable higher returns than those available from conventional forms of investment ("the highest returns in the safest environment") in addition to so-called "handsome referral commissions". The investment aims for investors with US100 to US$25,000 to invest, making it a working class type of fraud.

16. The funds are turned over to the investment and "earn" returns that range from 1.5% daily for a 7 day plan Plus the return of the initial investment to 2.67% daily for a 60 day plan or 160.2% plus the return of the initial investment. The weekly returns on the 7 day investment would amount to approximately 540% per year without taking into account the principal and the 60 day plan would return approximately 950% annualized.

17. Despite the excessive nature of these returns, the principal invested is said to be "guaranteed" by a "personal guarantee".

18. There is no explanation in the materials that I have examined as to the source of these excessive returns or how they can be guaranteed. The materials do state, however, that it is not invested in "public securities" or the stock market, "Forex" (which I understand to mean foreign exchange transactions), and is chiefly "offshore" and managed by "'EXPERTS' in their own fields".

19. In the course of the investment, the materials that I have reviewed describe another venture that was begun, sometimes described as "Energy Ltd.". "P2P Energy Bank", and other times described as a "global 'bank'". Coupled with this plan was the issuance of debit cards by which investors could withdraw their supposed funds.

B. The P2P Investment Compared to Legitimate Investment Opportunities and Transactions

20. While it is possible that a legitimate investment can occasionally yield a return in the ranges indicated in the materials, such returns in the times indicated are extremely rare and are not sustainable. Such investments are highly speculative and most such investments result not only in no returns but in the loss of principle.

21. In the legitimate world of financial investments, the return on an investment correlates with the perceived risk undertaken. The riskier the investment, the higher the return and the lower the perceived risk, the lower the return. In legitimate financial transactions risk is measured in a variety of ways which, while not perfect, provide a relate notion of the perceived riskiness of the investment. The return on obligations of the US government for a similar period sets the bench mark for relatively safe investments and investments deemed by rating agencies to be investment grade track the yield on Treasury obligations.

22. The returns indicated in the materials that I have examined for this scheme are so high that it would not be excessive to term them "extraordinary". Yet because the principal is guaranteed, they would be regarded as extremely safe. Moreover, the returns are described in the materials as being obtained from "low or medium risk ventures".Such combinations do not exist in the world of legitimate finance. These proposed returns turn the general rule regarding risk on its head, proposing to pay phenomenal returns for "safe" investments.

C. High Yield or Multi Level Pyramid Schemes

23. While it is my opinion that the investments described in the materials that I have reviewed do not resemble legitimate transaction, it is also my opinion that they do resemble and are, in fact, an instance of so-called high yield investment scams and of so-called Pyramid scams.

24. High Yield investment scams began to appear in a concentrated manner in the 1980s. They offered excessively high returns. Originally, they used different names since the term "high yield" was attached to a type of highly speculative legitimate investment at the time, one that involved investment in so-called "junk bonds" or bonds which were not rated by rating agencies because of the low creditworthiness of their issuers. At that time, they were known by a variety of names, the most infamous of which was "prime bank" investments, a name taken from the fact that the preposterous returns were often attributed to the involvement of a major (or "prime") bank. After the original meaning of "high yield" was forgotten and the term "prime bank" attracted unfavorable publicity, these schemes began to describe themselves as "high yield" investments.

25. Regardless of the name, they have common characteristics which do not necessarily have anything to do with the involvement of banks. Indeed, the investments are of two types, some are very specific regarding the nature of the investment, attributing the returns to some esoteric aspect of international finance such as forfeit or first demand guarantees.

Others are vague about the nature of the investment. Invariably, the esoteric sources of the returns turned out either to be fictions or not to yield such returns in the real world. On the other hand, the vague schemes were equally unreal. No real investment could simply avoid explaining its nature or character.

26. Multi Level Marketing schemes (sometimes referred to as "MLM") were quite common in the 1980s and early 1990s and when connected with high yield scams are invariably pyramid schemes. Recently, such combinations have been less common as their fraudulent character became exposed. The schemes play on notions of cooperative investment, with the pooling of funds to achieve a disproportionate return end. They involve incentives to attract other investors in the form of various financial incentives. frauds. It is also interesting to me that the materials themselves deny that P2P is a "failed" M.L.M. scheme.

27. There are a variety of characteristics common to commercial frauds. Some are always present and others are less omnipresent. These features include:
   a. returns that are disproportionate to the risk involved;
   b. the source of the return is obscured;
   c. entail unnecessary secrecy;
   d. contain references to attractive moral principles;
   e. do not involve investments that can return the promised yields;
   f. involve intricate explanations as to why the promised returns have failed to materialize.

28. While not all of these elements may appear in a single scheme, it is common for several of them to appear. The defining character of the scam is the promise of disproportionate returns.

29. Regulatory authorities and other responsible institutions of the leading developed countries have publicly warned about High Yield Investment Scams and have disassociated themselves from them, including the US Office of the Comptroller of the Currency (since 1986), the Federal Reserve (1993), all US banking regulators (1993), the Head of the Banking Supervision Division of the Bank of England (1994), the British Bankers Association (1993), the US Securities and Exchange Commission (1993), the International Chamber of Commerce (1993), the US Bureau of the Public Debt (1999), and UNCITRAL and the UN Commission on Drugs and Crime (2007). Since the initial warnings, numerous other warnings have been given and can be readily obtained by any person professionally experienced in finance or investment.

D. Resemblance of the Transactions in the P2P Materials to High Yield Features

30. As indicated, the feature most characteristic of a high yield scam is the disproportion between the supposed returns and the perceived risk. That feature alone would identify

the scheme described in the materials that I have reviewed as fraudulent. There are, however, other features of the scheme that reinforce this conclusion.

31. As also indicated, a similar characteristic of a species of high yield scam is the failure of the scheme to offer any explanation whatsoever of the source of the extraordinary returns and guaranteed. The failure of the materials that I have reviewed to account for its promised guaranteed returns other than suggesting that it chiefly from "offshore" sources marks it as belonging to this branch of the scheme. It is somewhat unusual in that it excludes several investment modes such as traded stock, pulicly traded securities, and foreign exchange (although such investments are not risk free and do not provide guarantees of the initial investment).

32. A typical characteristic of high yield scams is that they contain an international dimension. Such an attribution adds an element of glamour, makes it much more difficult for an investor to determine the authenticity of the claimed returns. An investor could convince him or herself: "Even though such returns cannot be obtained locally, perhaps it is possible in other countries."In fact, the same fundamental law about the correlation between risk and return applies everywhere. As indicated, the materials that I have reviewed peg the source of the promised extraordinary returns as being offshore and refer to the "international market" that they have attracted, falling into this pattern while providing some explanation for the source of the returns, however vague.

33. Another feature of high yield scams is a sense of exclusivity. This sense is honed to a high degree in multi level marketing programs. The notion is that investors are being introduced into a special network of investors with insights not accessible to ordinary mortals and obtained in part by pooling their resources. The materials that I have reviewed contain such features as illustrated by the use of the word "Club" to describe the venture, regular reminders that the program is by invitation only and that membership is by the grace of the team of fraudsters that control the program, regular allusions to the positive affect produced by pooling (enabling investors to earn dividends "totally out of reach for the average individual" and referring to accessing "the high interest that millionaires enjoy"), and its ability to garner the type of returns only available to the very wealthy, and regular appeals to the common interest and proper behavior.

34. Coupled with this sense of exclusivity, is the notion of confidentiality, another feature of high yield scams. The message is that the investment is by invitation only, not to be publicized, and that the investor is obligated to respect its confidentiality by not discussing it with outsiders. The materials that I have reviewed contain such references. The investor agrees that the material generated "must be kept private, confidential and protected from **any public disclosure**" [bold typeface in original]. The transactions are described as "private". The materials also state that "**[w]e will not tolerate nor accept any bad publicity of any nature, from anyone whatsoever**" [bold typeface in original] with the threat of expulsion in the event that this prescription is violated. When

complaints were made externally to service providers or supposed payment agents, scathing rebukes were made to the 'members".

35. In part, this notion of secrecy in commercial frauds is meant to discourage reporting the scheme to investment councilors or public authorities who would recognize it for what it is. In addition to the features mentioned above, the materials that I have examined contain implicit warnings that complaints to public authorities contribute to the delays in paying out funds. In a similar vein, the materials incorrectly state that the transactions are exempt from the UC Securities Act of 1933 and the Securities Exchange Act of 1934 and that the materials themselves are not solicitations for an investment, a tactic not uncommon in high yield scams.

36. In multi level marketing, there is an inconsistency with such a notion in that there are incentives to inducing others to invest. However, fraudulent commercial schemes are not noted for their internal consistency and such an inconsistency appears in the materials that I have examined. The materials that I have reviewed attempt to juggle this inconsistency by prohibiting advertising (unless it is approved) while offering incentives for finding new members and permitting them to inform relatives and friends and networking on a small scale without permitting general advertising.

37. As noted, the materials that I reviewed contain elements of a pyramid scheme. A pyramid scheme is one in which early investors earn returns from inducing investments by subsequent investors. The more investors that a person introduces, the greater the yield to the person who introduced them.

38. It is not uncommon for commercial frauds to contain or repeat warnings against similar frauds. This feature disarms suspicion with the notion that someone would not be warning about a fraud if it were itself such a fraud. The materials that I have reviewed contain several warnings about "H.Y.I.P." (which I understand to refer to "High Yield Investment Plans") and M.L.M.s (which I understand to refer to "Multi Level Marketing" programs). They also contain warnings to the effect that the fraudsters who have prepared the materials do not "believe" in them. Indeed, the materials that I have reviewed contain a perceptive critique of high yield programs (the interest that is offered is "ridiculous") and state that "[t]his 'Club' does not rely on new people joining to succeed or sustain...."

39. There is also a warning about the ponzi character of such schemes. The reference to "ponzi" schemes is derived from the scheme perpetrated by Charles Ponzi early in the 20th Century by which he paid earlier investors from the investments from subsequent investors or merely booked returns so that investors had large paper profits. Such schemes can only succeed provided that they balance the amounts withdrawn both by investors and the fraudsters themselves with the amounts invested. Recognizing its vulnerability to criticism, the materials cynically assure the investor that th funds pay "real returns/dividends". They also describe a high yield program as one that "uses the

funds from one investor to pay the next investors' commission."

40. The cynicism of the drafters of these materials shows in their tongue in cheek statement that their "programers" recommend the use of "H.Y.I.P." "Software". Even if there was such software, the underlying "joke" was that the same software would have worked because the P2P program was just another high yield scam.

41. Incidentally, I note that these references reveal the familiarity of those who developed this scheme with high yield and multi level marketing frauds. This familiarity is not surprising to me since the scheme that they have created is an instance of them but it is unusual for the scams to reveal their awareness of the nature of these schemes so expressly.

42. As indicated, high yield scams often contain references to the altruistic nature of the program or those involved in it, seeking to appeal to this aspect of human nature in part in the hope that such an appeal will result in the suspension of prudent judgment about those who have (or claim to have) such traits. While not a major feature of the materials that I have examined, there is a reference in them to the "strong moral foundations" that underlie the scheme.

43. It is not uncommon for high yield investments to refer to themselves as "legal" and to use the term "clean", sometimes in reference to the funds that they receive or pay. Sometimes they require such a statement from investors. While the materials that I have reviewed do not use the common formula, they do contain a statement that the program is legal. While odd, this term alone is not decisive. However, the statement is that they program is "legal and clean". The term "clean" has no meaning in this context in legitimate investments and in my opinion is drawn from the family of high yield frauds that commonly use it.

44. In rendering my opinion, I am not unmindful of the disclaimers made in the materials that I have reviewed. It is not uncommon for high yield scams to contain such disclaimers in an attempt to provide the fraudsters with excuses or defenses in the event of inevitable complaints. Such attempts to avoid liability must be read in the context of the entire scheme. A few lines in pages of materials that suggest that the investor assumes all risk, particularly when they contradict the inducements and guarantees, would be readily overlooked by any investor and does not, in my opinion, alter the fraudulent character of a program promising impossible guaranteed returns. In this vein, the materials state that the investor agrees to indemnify and hold the principals harmless from "any liability". They also state that the investment is at the investors own risk, despite the guarantee that is prominently given, and that past performance "is not an explicit guarantee for the same future performance", conveniently ignoring the promised returns which are not said to be dependent on any such contingencies and do not refer to past performance but are promises of future performance.

45. I note that the materials that I have reviewed state that the investments are undertaken by

experts in their fields. Such claims are common in high yield investment scams. In my opinion and experience, any expert or and most experienced investment counselor would immediately recognize the fraudulent character of the scheme described in the materials.

46. It is difficult from the materials to determine the full scope of the Energy Ltd. program and the plan to obtain debit cards. Attempts to imitate a bank or to provide debit cards are advantageous for a high yield scam in that they provide the appearance of legitimacy. However, claiming to be a bank or, as the materials sometimes qualify it, a "bank" does not make something a bank. Moreover, one need not be a bank to distribute debit cards. It is not clear from the materials whether the debit card program was ever launched but, even it it was, it merely would constitute a private label arrangement by which the program would fund withdrawals through a third party service provider. In the past, I have encountered high yield scams with such features.

47. As indicated, it is common for high yield programs to generate numerous excuses when, as is inevitable, investors are unable to obtain their funds. Such excuses are intended to pacify investors, generate sympathy, or await the investment of further funds. The materials that I have reviewed contain numerous examples of such excuses. Delays are blamed on computer "glitches", program failures, errors, trips, failure of investors to comply with rigid and counter-intuitive rules, failure to fill out forms properly, excessive demands on staff, marriages, third party providers, and the Great Recession of 2008/9. They are coupled with threats and warnings as well. A classic example is the expression of perplexity as to why anyone of good will would not "appreciate the opportunity" to earn "the returns we are being paid" and as to why they would "complain and moan" "if there is a 30, 60, 90, or even 120 day delay".

V. CONCLUSIONS

48. It is my considered professional opinion that the programs described in the P2P materials that I have reviewed constitute an instance of high yield and multi level marketing fraud and are not legitimate.

49. It is also my opinion that the materials that I have reviewed were deliberately constructed to give the impression of legitimacy and to entice unsophisticated investors.

Executed on Monday, 2 November 2009 at Montgomery Village, Maryland.

[redacted]

James E. Byrne

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

DECLARATION OF PROFESSOR TODD T. MILBOURN

I, Professor Todd T. Milbourn, declare under penalty of perjury pursuant to 28 U.S.C. Section 1746:

I. INTRODUCTORY STATEMENT

1. I have been requested by counsel for the United States (hereafter "US") to render my expert opinion in the litigation against Pathway to Prosperity Network or the P2P Network (hereafter "P2P"). I have been specifically asked to comment on the claimed rates of return on the four investments plans offered by P2P.

2. I understand that it is my duty to express my expert opinion independently of any influence or advocacy.

3. In rendering my opinion, I have examined the documents indicated in Exhibit A and data sources listed in Exhibit C. The documents listed in Exhibit A include screen captures of two webpages that were provided to me by the US Attorney's office for analysis, hereafter denoted "P2P Welcome" and "P2P FAQ". My opinion is subject to revision should further information or documentation be provided to me.

4. I have rendered my opinion in light of my experience, knowledge, research, and studies in the field of finance, investments, and capital markets.

5. My Declaration is organized as follows:

II. QUALIFICATIONS

6. For more than 16 years, I have lectured and taught courses in the areas of corporate financial management, financial performance measurement, investments, and financial markets to asset managers, bankers, business people, consultants and lawyers in more than eight countries throughout the world.

Attachment B

7. For more than 15 years, I have presented the findings of my own research on corporate finance, financial markets, performance measurement, and executive compensation to academics, bankers, business people, and consultants in over 14 countries throughout the world.

8. I have published over 18 research articles in the area of financial economics. These scholarly works have appeared in top scholarly journals and premier practitioner outlets. I have also co-written a book on Corporate Finance that is in its fourth edition. My qualifications and publications are set forth in my resume which is attached as Exhibit E.

9. I have served as an ad hoc referee for over 15 top finance and economics research journals. I have also served on the program committees of several top global finance conferences.

10. I have been a full-time faculty member at the Olin Business School at Washington University in St. Louis since August 2000. I teach subjects related to finance, investments, corporate financial management, financial performance measurement and financial markets to undergraduate, MBA, MS in Finance, and Executive MBA students. I also teach regularly in Olin Business School's Executive MBA program in Shanghai, China.

11. Prior to joining Washington University full-time in August 2000, I was on the full-time faculty at the London Business School from 1996 to 1999. There I delivered courses on finance to MBA students and executives. I spent the academic year of 1999 to 2000 as a Visiting Assistant Professor of Finance at the University of Chicago's Graduate School of Business, teaching several courses on corporate financial management.

12. I have received the following degrees: PhD in Business (Finance), Indiana University (1995); B.A., magna cum laude, Augustana College (May 1991). My doctoral studies were specialized in the area of financial economics. My undergraduate studies included majors in Business Administration (Finance), Economics, and Mathematics, with a minor in Computer Science.

III. SUMMARY OF OPINIONS

13. In my considered professional opinion, each of the four investment plans described in the P2P FAQ page offer rates of return to investors that are extraordinarily high. Secondly, these promised returns are wholly unreasonable when compared to the rates of return that have been earned historically on other legitimate investments in financial markets, including, but not limited to those in US Treasury Securities, US stocks that trade on the New York Stock Exchange (hereafter "NYSE") and NASDAQ, stocks that trade in other economically developed countries and those that trade in emerging markets. Thirdly, the claim that the exaggerated returns of P2P come with an alleged guarantee of principal is also wholly unreasonable. As investors seek out higher returns on their investments, the risk of losing one's money strictly goes up. Finally, the purported investment plans grossly exceed the rates of return earned historically by professional money managers who are extensively trained and ultimately paid for these money management services. The promised rates of return in the P2P investment plans greatly exceed even the rates of return earned by corporate insiders trading on their own company's stock. With these facts in mind, there is no rational basis for P2P's purported investment returns.

IV. EXPLANATION OF OPINIONS

A. Rates of Return Implied by P2P

14. According to the P2P FAQ, there were four Investment Plans offered, and each of these stated a daily interest rate that would be earned in the plan. These four plans are the "7 Day Plan", the "15 Day Plan", the "30 Day Plan", and the "60 Day Plan". The daily interest rates for these four plans are 1.5%, 1.75%, 2% and 2.5%, respectively. Taking the "7 Day Plan" as an example, an investment of $1 would generate 1.5% in interest daily for each of the 7 days in the plan. This would leave the investor with a total of 10.5% interest earned after 7 days (which is calculated as 7 times 1.5%). The interest earned during the plan could be calculated similarly for each of the other three plans by adjusting the daily interest rate and the number of days in the plan.

15. In order to compare P2P's promised interest rates to legitimate investments available to investors, I convert them to an annualized basis. There are two generally accepted methods for calculating annual returns. The two methods differ only with regard to whether the interest earned at the end of a particular investment plan's term is withdrawn from the account (denoted Scenario 1 in what follows) or whether the interest itself is reinvested into its own plan (denoted Scenario 2 in what follows). The concept of re-investing the earned interest back into a plan allows for an investor to earn interest on interest, which is otherwise referred to as compound interest.

16. Both types of investing choices were allowed at P2P, as noted in the P2P FAQ, under the section entitled "What are the LIMITS for making Investments & Withdrawals?". Specifically, that document reads "Once an Investment Plan has reached maturity, you may then either re-invest or request to make a withdrawal, in any amount you choose. You may withdraw just a portion or ALL of your funds, just as you may re-invest just a portion or ALL of your funds". Thus, these two methods for annualizing rates of return are reasonable for the P2P situation.

17. The purported rates of return promised by P2P are inordinately large when compared to legitimate investment returns using either method of annualization. These calculations are described in Exhibit D. In the more conservative case (denoted Scenario 1), the annual rate of interest earned is calculated under the assumption that the investor first invests an initial amount (denoted the "Principal") in the plan and earns the promised interest (denoted by P2P as "profits") over the term of that plan (e.g., 7 days). Once the plan ends, I assume that the investor takes the interest (profits) earned out of the account, but re-invests the principal into a new plan of the same term (e.g., 7 days). Over an entire year, the investor would have invested in 52 individual 7-day plans. Using this conservative approach that repeatedly re-invests the principal only in consecutive 7-day plans promises an annual return of 546%. Using the same rollover approach for the other three investment plans, the 15-day plan promises an annual return 630%, the 30-day plan promises an annual return of 720%, and the 60-day plan promises an annual return of 900%.

18. Observe that under a more realistic approach to investing over the year, I find significantly higher returns. In Scenario 2, I assume that at the end of each plan, the investor re-invests both the principal and the earned interest (profits) back into a new plan with the same term, and repeats this over the entire year. Such a reinvestment policy is quite typical for investors. Under this assumption, the P2P promised rates of interest grow exponentially. In the 7-Day plan alone, such a strategy should deliver an annual rate of return of over 17,000%. The other three plans result in annualized rates of return each in excess of 20,000%. Below, I will support my statement that P2P's promised rates of return can't be reconciled with any legitimate investment opportunities using the more conservative calculations of Scenario 1. However, the case is even easier to make if I use the significantly greater rates of return implied by Scenario 2.

B. Rates of Return Earned in Legitimate Investments

19. I argue that the purported rates of interest in all four plans are wholly unreasonable based on my understanding and research of financial market history. The basis for this statement is the fact that I can find no legitimate investments that can systematically deliver rates of return of these magnitudes. In fact, the average rates of return that can be documented from legitimate investments are at least an order of magnitude lower. That is, they are less than one tenth of the rates promised by P2P in even the lowest yielding 7-Day plan and its 546% annual rate of return.

20. In this subsection, I document the historical returns an investor could have legitimately earned in nine different investment plans. These investment plans include investments in bonds, stocks, and individual companies. I also include two international investments among these nine. In all cases, the average return earned (shown in row 4 of Exhibit C) is only a fraction of those promised by P2P. Even more strongly put, if one considers only the highest annual returns ever earned on any one of these investments (shown in row 6), the greatest of these numbers (102.5%) is still less than one fifth of the promised return of P2P's lowest-yielding 7-Day plan.

21. Columns 1 and 2 of Exhibit C consider investments in US Treasury Bills and US Treasury Bonds over the years of 1928 to 2009. As shown in row 4, the average return delivered to investors holding these investments were 3.7% and 5.2%, respectively. These returns are less than one hundredth of those lowest-yielding returns purported by P2P.

22. We can now turn to investments in stocks. I begin by calculating the returns earned by an investor holding the 500 stocks contained in the popular index known as the S&P 500. As can be seen in column 3 of Exhibit C, over the years of 1928 to 2009, the average return delivered to stockholders in the S&P 500 was 11.3%. This is grossly less than the promised rates of return of P2P that exceeded 500% annually in all four P2P plans. Column 4 reveals that an investor holding the stocks listed on the NASDAQ averaged a return of 13.1% annually over the years 1973 to 2009. Thus, while an investor would have fared better holding stock listed on the NASDAQ exchange over those contained in the S&P500, these returns are again less than one fortieth of those promised by P2P.

23. Investors need not only invest in stocks listed in the US, they can also invest in global companies. I consider two global investment plans. The first constitutes an investment in companies in all developed nations except for the US and Canada. As seen in row 4 of Exhibit C, the average return earned on such an investment over the years 1970 to 2009 is 11.9%. Greater returns were earned over the years 1988 to 2009 by investing in companies that trade in emerging markets, such as Brazil, China, India and Russia, among 18 others. An investment in these emerging markets yielded an average return of 20.0%, which is much less than one twentieth of the purported returns of P2P.

24. One greatly-renowned investor in the financial market landscape is Mr. Warren Buffett. Mr. Buffett is the Chairman and CEO of Berkshire Hathaway, a conglomerate holding company whose stock is publicly traded on the NYSE. As a conglomerate holding company, Berkshire Hathaway makes investments in other companies and businesses. Mr. Buffett's nickname is the "Oracle of Omaha", capturing his alleged prowess as being among the best investment manager on the street. As calculated in Exhibit C for the aforementioned investments, we can examine the performance of Berkshire Hathaway as well. As can be seen in column 7, over the years of 1977 to 2009, row 4 highlights that the average return delivered to stockholders in Berkshire Hathaway was 27.3%. While more than double the average return of the S&P 500 over this time period, it is grossly less than the promised rates of return of P2P that exceeded 540% annually in all four

plans. In fact, P2P is purporting to deliver rates of return more than 20 times larger than the average performance delivered by the renowned Mr. Warren Buffet. Even more striking is that P2P is purporting to deliver investment returns more than five times greater than Mr. Buffet's best year ever, which was 102.5%.

25. I was advised by the U.S. Attorney's Office of an oral claim by the principal of P2P that P2P had invested in casinos and real estate. I cannot ascertain in which casino companies or real estate firms that P2P allegedly invested, but I can examine the historical returns earned on a sampling of both types of these firms. Columns 8 and 9 of Exhibit C summarize the return performance of a portfolio of three casino (gaming) companies and three real estate investment trusts (REIT). Each of the three firms in both the casino group and the REIT group were chosen because they were among the largest five companies in the industry according to Yahoo Finance and had stock return data available for at least 15 years. As summarized in row 4, over the years 1995 to 2009, the gaming firms generated an average return of 31.9% and the REIT firms an average return of 12.5%. Both of these are significantly less than the purported P2P returns. In addition, even the best year experienced for the gaming group (101.9%) and REIT group (44.8%) are less than one fifth and one tenth, respectively, of those promised by P2P.

26. Summing up this subsection, as shown in row 4 in Exhibit C, these nine alternative investment strategies delivered average annual returns that range from 3.7% at the low end, to 31.9% at the high end. Similarly, the highest annual returns earned ever by these nine alternative investment strategies (shown in row 6) range from 14.3% to 102.5%. I claim that the P2P proposed rates of return are wholly unfounded on the basis that these legitimate returns are only a relatively small fraction of those purported by P2P.

C. Discussion of P2P's Guaranteed Returns

27. Under "General Policies" on the P2P FAQ webpage, P2P states that "[t]he most important aspect of our personal investments, which range from low, medium to high returns are based on the fact that our principal investment is always guaranteed." A guarantee on the principal amount of an investment requires that the investment can never lose money. Finance professionals refer to a guaranteed investment as one that has no risk, otherwise known as a risk-free investment. In terms of rates of return that an investor could expect to earn, a guarantee of principal implies that the investment plan can never generate a negative rate of return. Observe that if an investment generates a negative rate of return in a particular year, then some amount of the original principal has been lost, which would violate the guarantee.

28. In my opinion, P2P's statement of a guaranteed investment cannot be supported by any legitimate financial market data and is thereby unreasonable. There are nine different investments considered in Exhibit C, including investments in bonds, domestic stocks, and international stocks. For each investment listed in columns 1 through 9, row 8 displays the number of years in which the investment had a negative rate of return out of all the years considered in the data analysis. Row 9 takes the number of years with negative returns and displays this result as a percentage of all the data years available for that particular investment. Consider the first column which examines investments in US Treasury Bills. According to the data, over the years 1928 to 2009, there is not a single year in which an investor holding US Treasury Bills lost money. In contrast, it can be seen in column 2 that an investor in US Treasury Bonds (which, similar to US Treasury Bills are investments backed by the US Treasury, but are of a longer term) suffered a negative return in 15 years out of the 82-year sample, which is over 18% of the time.

29. As one can see from an examination of row 8 for the remaining seven investments in columns 3 through 9, guarantees are nonexistent as one considers investments besides those in US Treasury Bills. For instance, an investment in stocks such as those in the S&P 500 Index suffered negative returns in 29.3% of the years (24 years in total out of 82) across 1928-2009. Berkshire Hathaway delivered negative rates of return in 15% of the years studied (5 out of the available 33 data years). Since each of these investments outside of US Treasury Bills suffer losses at least some of the time, it is completely unreasonable that P2P could provide a guarantee.

30. While understanding the percentage of time an investment might lose money is clearly an important dimension of assessing an investment's risk, what is arguably even more important is an assessment of how much money could be lost on an investment when it goes badly. For example, as seen in Exhibit C, US Treasury Bonds suffered negative returns in 15 of the 82 years over 1928-2009, whereas stocks in the S&P 500 collectively lost money in 24 of those years. At first blush, this might not seem terribly different. However, what is missing in this comparison is a consideration of how vastly different the losses are on these two investments in those down years. Row 10 displays the average return earned by an investor in just those years in which the investment lost money. For US Treasury Bonds, we see that while investors holding these bonds lost money about 18% of the time, in those down years, their average return was only -3.7%. In contrast, while investors in the S&P 500 lost money about 29% of the time, when they did lose money, they lost nearly four times as much, earning returns that averaged -13.7%.

31. An even simpler way to conclude that an investment in the S&P 500 was riskier than one in US Treasury Bonds is to highlight the fact (as shown in row 5) that the worst an investor in US Treasury Bonds ever did was to lose 11.1% of their value in a particular year, whereas the worst an investor in the S&P500 did was to lose 43.8% of value in one year. Along these lines, finance professionals rely on a measure known as volatility (or standard deviation in statistics terms) to capture these extremes. Volatility is a measure of how spread out (or dispersed) the rates of return on an investment could be in any particular year. Such a measure will account for how low the rates of return might go, as well as how high the rates of return might go.

32. An investment with a low volatility should deliver rates of return that fall between a narrow range. US Treasury Bills, for example, have a very low volatility of 3%. This low volatility number obtains because over an 82-year period, the actual returns on an investment in US Treasury Bills only ranged between 0% at the low end and 14.3% at the high end. Investments in stocks in the S&P 500, on the other hand, have a higher volatility of 20.3%. This volatility estimate that is nearly six times greater than that of US Treasury Bills is because of the fact that over the same 82-year period, the actual returns on an investment in the S&P 500 ranged between -43.8% at the low end and 52.6% on the high end.

33. Exhibit C contains the estimates of volatility for each of the nine investment strategies mentioned above. In row 7, it can be seen that these estimates vary from low values, such as 3.0% for investments in US Treasury Bills, to higher values, such as 37.5% for investments emerging market companies. Observe that only investments in US Treasury Bills and Bonds have volatilities of less than 10%, whereas all investments in stocks (either domestic or global) come with average volatilities of over 28%. It can be noted that even Mr. Warren Buffet's outstanding performance did not come without its own risks, as the volatility of his company's stock return was 31.5%, which is also nearly double the volatility of the S&P 500 return over this same period. The Berkshire Hathaway example captures a well-known principle in finance: if one seeks out higher returns on investment over time, such returns will be accompanied by greater volatility (i.e., greater risk). This implies that P2P's extraordinarily high purported rates of return could not possibly be paired with a guarantee.

D. Rates of Return Earned on Alternative Investments

34. An investor seeking out greater investment returns might also consider investing with a professional money manager. These could include investing in a mutual fund or a hedge fund (each of these is described in detail below).

35. There is a very extensive market for individuals to invest their money in the financial market. The means by which most individuals invest their money is to hire an investment manager. One large class of these investments takes the form of a mutual fund. In what is considered by most professionals to be among the best finance textbooks available, Richard Brealey, Stewart Myers and Franklin Allen (hereafter "BMA") in their book define a mutual fund as "Managed investment fund whose shares are sold to investors".

36. According to a study published in the Journal of Finance in 2000 by Russ Wermers (hereafter "RW"), if one averages the annual rates of return earned by mutual fund managers over 1975 to 1994, we find that these fund managers earned 1.3% more than a investor would have earned by simply holding a broad stock index comprised of the S&P 500 stocks. The strategy of holding the S&P 500 as an investment is commonly referred to as a passive investment strategy.

37. From the above finding, one can conclude that at least some investment professionals are able able to earn rates of return that are better than a passive strategy of investing in, for example, the S&P 500 index. However, there are two important caveats to this statement. First, mutual funds did not outperform the S&P 500 benchmark in every year. In fact, they only outperformed it in 13 out of 20 years in the RW study. In the other 7 years, mutual fund managers delivered an average return that fell short of the return on the investment in the S&P 500. Such variation in performance implies that there is a risk (or a lack of guarantee) when investors seek out higher rates of return. Interestingly, BMA highlight for a sample of mutual funds spanning the years 1962 to 2008 (see Figure 13.5 in BMA) that mutual funds underperformed the stock market for approximately two-thirds of those years.

38. A second caveat to the finding that mutual funds on average did better than the return earned on the S&P 500 stock is that fact that investors pay significant fees and transaction costs to invest their money in a mutual fund. In the RW study, these fees and transaction costs averaged 1.6%, which more than eats up outperformance earned of 1.3%.

39. I can summarize the evidence from the performance of professional mutual fund managers as follows. While the investments styles of mutual fund managers may vary over time, as documented by RW, there is only limited evidence on the ability of these managers to outperform (i.e., deliver higher rates of return than) the overall market. When the outperformance does occur, however, RW documents that it is relatively modest at 1.3%. In addition, in the pursuit of these returns, an investor paid fees and costs averaging 1.6%, which more than offsets the 1.3% gained.

40. There are other alternatives to mutual funds available to an investor. One such alternative can be found in the universe of hedge funds. Hedge funds are perceived as vehicles that offer the potential for earning large investment returns since these investment funds can invest in a wider range of securities. BMA define a Hedge Fund as "An investment fund charging a performance fee and open to a limited range of investors. Funds often follow complex strategies including short sales. [A] Short Sale is the "sale of a security that the investor does not own."

41. Hedge funds face less stringent disclosure requirements, and thus data on the performance of these investments is more difficult to obtain than the aforementioned investment examples.

Several private companies have emerged to collect data on performance from hedge funds. Hedge funds voluntarily disclose their performance to many of these data collection services.

42. Leading finance scholars have examined the data from these collection service agencies. One prominent example includes the scholarly work of Burton G. Malkiel and Atanu Saha, published in the *Financial Analysts Journal* in 2005. Relying on the universe of hedge funds sampled in the TASS Database, they find that hedge funds earned an average annual rate of return on their investments of 8.82% over the years 1995 to 2003. Analogous to the findings above, this average rate of return was higher than say the average return on US Treasury Bonds (5.2%), but the volatility of these hedge fund returns was also higher at 9.2%.

43. In other scholarly work examining hedge fund that is forthcoming in the *Journal of Finance*, Vikas Agarwal, Naveen D. Daniel, and Narayan Y. Naik examine a larger data sample of hedge funds over the years 1994 to 2002. Their data sample merge the TASS Database mentioned above with three other data sources, including CISDM, HFR, and MSCI. These researchers find that the average annual rate of return earned by these hedge funds was 12.2%. This higher return was coupled with an observed volatility of 26.4%.

44. To put the purported P2P rates of return to a further reality check, one can also look at the returns earned on the trades of corporate insiders. A corporate insider is formally defined as a corporate officer, director, or any shareholder who owns 10% or more of the company's stock. It is important to distinguish between legal and illegal insider trading. Any corporate insider can legally trade the stock of the company to which the individual is considered an insider. However, there are restrictions on these trades. The individual must abide by a set of SEC rules regarding the timing of trades (e.g., they cannot be made around a firm's earnings release dates) and how these are to be disclosed to other shareholders through an SEC filing (denoted as Form 4 filings). There are hundreds of thousands of instances of legal insider trades as documented in SEC Form 4 filings, and of course instances where the SEC detects illegal insider trades. As will be described below, illegal insider trading may be carried out by individuals that are not formally defined as insiders to the company, but have acquired a privileged information position first-hand or second-hand (where the latter is referred to as being a 'tippee').

45. There are financial researchers that have examined the impact of insider trades, including both legally allowed insider trades and detected cases of illegal insider trades.

46. In a paper published in the scholarly journal, *The Review of Economics and Statistics*, Leslie A. Jeng, Andrew Metrick, and Richard Zeckhauser (hereafter "JMZ") study over 200,000 legal insider purchases of stock over the time period of January 1, 1975 through May 31, 1996. They find that when one aggregates all of these stock purchases legally made by corporate insiders, they combine to earn a return that is on average 11.2% higher than that earned by the overall stock market on average. To put this number into context, over the time period of 1975 to 1996, the S&P 500 Index averaged a rate of return of 16.6%. Therefore, one can think of corporate insiders earning an average rate of return of approximately 27.8% on their insider trades (calculated as 16.6% + 11.2%). While a 27.8% return is significantly greater than the return on the market, it is again nowhere near the purported rates of return of P2P.

47. Turning to illegal insider trades, in a paper published in the *Journal of Finance*, Lisa K. Meulbroek (hereafter "LM") studies insider trading cases brought by the SEC over the years 1980 to 1989. LM finds that based on these illegal activities for a sample of 320 defendants involved in 183 cases of insider trading, these defendants earned approximately a 30% return over a 14-day period. Such a return is roughly what the 15-Day Plan of P2P purports to generate. Thus, only an

illegal insider trade seemingly comes close to that claimed by P2P. However, while an individual investor might have (illegally) earned such a high rate of return a single time, there is no rational basis for suggesting that the same insider could repeat this feat 24 consecutive times as is purported by P2P in their 15-Day Plan. Therefore, as above, the ability of an investor to earn the rates of return promised by P2P cannot be justified even on the basis of illegal insider trading.

V. CONCLUSIONS

48. It is my professional opinion that the investment returns described in the P2P materials that I have reviewed are wholly inconsistent with any investment returns that have been earned historically in domestic (U.S.A) or global financial markets. I can find no such evidence of legitimate investment strategies that historically would have delivered even a modest fraction of the purported investment returns of P2P. In addition, I can find no such evidence to support the claims of P2P to guarantee their investment plans.

49. My conclusion is that the returns purported in the P2P website materials are grossly exaggerated and seemingly outrageous given the investment returns that can be documented from legitimate and documented investment strategies over time.

I DECLARE UNDER PENALTY OF PERJURY THAT THE FOREGOING IS TRUE AND CORRECT.

Dated: May 26, 2010.

[redacted]

Todd T. Milbourn

VI. EXHIBIT A: REFERENCES FOR ANALYSIS

50. Agarwal, Vikas, Naveen D. Daniel, and Narayan Y. Naik, "Role of Managerial Incentives and Discretion in Hedge Fund Performance", forthcoming in the *Journal of Finance*.

51. Brealey, Richard A. ,Stewart C. Myers, and Franklin Allen, *Principles of Corporate Finance*, 10th edition, McGraw-Hill Irwin Publishers, 2011.

52. Jeng, Leslie, A., Andrew Metrick, and Richard Zeckhauser, "Estimating the Returns to Insider Trading: A Performance-Evaluation Perspective", *Review of Economics and Statistics* Volume 85-2, 2003, 453-471.

53. Malkiel, Burton G., and Atanu Saha, "Hedge Funds: Risk and Return", *Financial Analysts Journal*, Volume 61-6, 2005, 80-88.

54. Meulbroek, Lisa K., "An Empirical Analysis of Illegal Insider Trading", *Journal of Finance*, Volume 47-5, 1992, 1661-1699.

55. Screen capture from http://web.archive.org/ for the "Welcome to P-2-P Network" webpage (denoted "P2P Welcome") from www.pathway-2-prosperity.net, April 6, 2010.

56. Screen capture from http://web.archive.org/ for the "Frequently Asked Questions" webpage (denoted "P2P FAQ") from www.pathway-2-prosperity.net, April 6, 2010.

57. Wermers, Russ, "Mutual Fund Performance: An Empirical Decomposition into Stock-Picking Talent, Style, Transaction Costs, and Expenses", *Journal of Finance*, Volume 40-4, 2000, 1655-1695.

VII. EXHIBIT B: SOURCES USED IN DATA ANALYSIS

58. Data summarized in columns 1-3 are drawn from the Updated Data tab at the trusted source of http://pages.stern.nyu.edu/~adamodar/.

59. Data summarized in columns 4, 7, 8, and 9 are drawn from *The Chicago Research in Securities Prices* database as accessed through *Wharton Research Data Services*.

60. Data summarized in columns 5 and 6 are drawn from http://www.mscibarra.com/.

61. Data summarized in column 7 are drawn from the published work of Russ Wermers,

62. The six companies included in columns 8 and 9 were identified using Yahoo Finance based on their market capitalization as of market close on May 24, 2010.

VIII. EXHIBIT C: SUMMARY TABLE OF YEARLY RETURNS ON VARIOUS INVESTMENTS OVER TIME

Annual Returns on Investments in Various Securities over Time Periods Available

	Year	US Treasury Bills	US Treasury Bonds	S&P 500 (incl. dividends)	NASDAQ (incl dividends)	MSCI EAFE (Global Stock Market Index of Developed Markets) (Europe, Australasia, Far East) (Excluding US & Canada)	MSCI Emerging Markets Index Fund (EEM)	Berkshire Hathaway (BRK.A)	Gaming Industry Firms	REIT Industry Firms
Row/Column		1	2	3	4	5	6	7	8	9
1	Number of Data Years	82	82	82	37	40	22	33	15	15
2	First Year of Data	1928	1928	1928	1973	1970	1988	1977	1995	1995
3	Last Year of Data	2009	2009	2009	2009	2009	2009	2009	2009	2009
4	Average Yearly Return	3.7%	5.2%	11.3%	13.1%	11.9%	20.0%	27.3%	31.9%	12.5%
5	Lowest Annual Return in Sample	0.0%	-11.1%	-43.8%	-40.2%	-43.4%	-53.2%	-31.8%	-58.1%	-34.9%
6	Highest Annual Return in Sample	14.3%	32.8%	52.6%	83.7%	69.4%	79.0%	102.5%	101.9%	44.8%
7	Standard Deviation of Annual Returns(Volatility)	3.0%	7.8%	20.3%	28.1%	23.0%	37.5%	31.5%	41.4%	18.0%
8	Number of Years That Investment Return Was Negative	0	15	24	11	11	9	5	4	2
9	Percentage of Years That Investment Return Was Negative	0.0%	18.3%	29.3%	29.7%	27.5%	40.9%	15.2%	26.7%	13.3%
10	Average Return in Years Return is Negative	N/A	-3.7%	-13.7%	-20.6%	-16.8%	-16.9%	-16.3%	-17.0%	-18.7%

IX. EXHIBIT D: INTEREST RATE CALCULATIONS OF P2P INVESTMENT PLANS FOLLOWS

The Purported Rates of Return on the Four P2P Investment Plans

There are two scenarios considered for each of the four investment plans, and the interest that would be allegedly earned by an investor is calculated for both scenario. In what follows, for each of the four investment plans, I first calculate the interest earned by the investor over the first term. In the case of the 7-Day Plan, this would mean the interest earned over those first 7 days. I then consider two standard reinvestment scenarios, which are described here:

- Scenario 1: Investor puts $1 into plan and then takes out only the interest (profits) at the end of each plan. The principal amount is then re-invested in the same plan repeatedly for the entire year.
- Scenario 2: Investor puts $1 into plan and leaves both her principal and interest (profits) in her account. Both the principal and profits are re-invested in the same plan repeateddly for the entire year.

7-Day Plan: 1.5% Daily Interest

- Simple interest earned over 7 days: $(0.015 \times 7) = 0.105 = 10.5\%$ interest earned in 7 days.
  - $1 generates $0.105 in profits after 7 days
- Scenario 1: Simple interest earned if interest (P2P profits) are withdrawn and only principal put back to work for 52 weeks:

$$10.5\% \times 52 = 0.105 \times 52 = 5.46 = 546\%$$

  - $1 generates $5.46 in profits after 1 year
- Scenario 2: Annualized Rate of Return if we roll over the profits and principal each week for 52 weeks:

$$(1 + 10.5\%)^{52} - 1 = (1 + 0.105)^{52} - 1 = 17,882\%$$

  - $1 generates $178.82 in profits after 1 year

15 Day Plan: 1.75% Daily Interest

- Simple interest earned over 15 days: $(0.0175 \times 15) = 0.2625 = 26.25\%$ interest earned in 15 days.
  - $1 generates $0.2625 in profits after 15 days
- Scenario 1: Simple interest earned if interest (P2P profits) are withdrawn and only principal put back to work for 24 semi-monthly periods:

$$26.25\% \times 24 = 0.2625 \times 24 = 6.3 = 630\%$$

  - $1 generates $6.30 in profits after 1 year
- Scenario 2: Annualized Rate of Return if we roll over the profits and principal over these 24 semi-monthly periods:

$$(1 + 26.25\%)^{24} - 1 = (1 + 0.2625)^{24} - 1 = 26,788\%$$

  - $1 generates $267.88 in profits after 1 year

30 Day Plan: 2% Daily Interest

- Simple interest earned over 30 days: $(0.02 \times 30) = 0.6 = 60\%$ interest earned in 30 days.
  - $1 generates $0.60 in profits after 30 days
- Scenario 1: Simple interest earned if interest (P2P profits) are withdrawn and only principal put back to work for 12 monthly periods:

$$60\% \times 12 = 0.6 \times 12 = 7.2 = 720\%$$

  - $1 generates $7.2 in profits after 1 year
- Scenario 2: Annualized Rate of Return if we roll over the profits and principal each month for 12 months:

$$(1 + 60\%)^{12} - 1 = (1 + 0.6)^{12} - 1 = 28,047\%$$

  - $1 generates $280. 47 in profits after 1 year

60 Day Plan: 2.5% Daily Interest

- Simple interest earned over 60 days: $(0.025 \times 60) = 1.5 = 150\%$ interest earned in 60 days.
  - $1 generates $1.50 in profits after 60 days
- Scenario 1: Simple interest earned if interest (P2P profits) are withdrawn and only principal put back to work for 6 bi-monthly periods:

$$150\% \times 6 = 1.5 \times 6 = 9 = 900\%$$

  - $1 generates $9.0 in profits after 1 year
- Scenario 2: Annualized Rate of Return if we roll over the profits and principal each month for 6 bi-monthly periods:

$$(1 + 150\%)^{6} - 1 = (1 + 1.5)^{6} - 1 = 24,314\%$$

  - $1 generates $243.14 in profits after 1 year

X. EXHIBIT E: RESUME OF TODD T. MILBOURN FOLLOWS

TODD T. MILBOURN

Olin Business School
Washington University in St. Louis
Campus Box 1133
1 Brooking Drive
St. Louis, MO 63130-4899

AREAS OF RESEARCH AND TEACHING INTERESTS

Corporate finance, CEO compensation, valuation, credit ratings, and corporate governance.

EDUCATION

Ph.D. in Finance, Indiana University, November 1995
B.A. in Economics, Finance, and Mathematics, Augustana College, May 1991

ACADEMIC EXPERIENCE

Hubert C. and Dorothy R. Moog Professor of Finance, Washington University in St. Louis, 2010+
Professor of Finance, Washington University in St. Louis, 2007-2010
Associate Professor of Finance (with tenure), Washington University in St. Louis, 2003-2007
Visiting Associate Professor of Finance, University of Chicago, Spring Quarter 2005
Assistant Professor of Finance, Washington University in St. Louis, 2000-2003
Visiting Assistant Professor of Finance, University of Chicago, 1999-2000
Assistant Professor of Finance, London Business School, 1996-1999

ADMINISTRATIVE AND OTHER EXPERIENCE

Finance Area Coordinator, Washington University in St. Louis, 2005-present
Academic Director, MS in Finance Program, Washington University in St. Louis, 2005-2008

- Responsible for the design, development, implementation and academic direction of this new one-year, full-time MS in Finance Program.

Board Member and Co-Founder, *St. Louis Military Officer Support Foundation*, 2008-present

- www.buildwarriors.org

RESEARCH AND HONORARY APPOINTMENTS

Member, Standard & Poor's Academic Council, 2004-present
Fellow, Center for Financial Research, FDIC, 2004-2005
Marcile and James Reid Chair, Washington University in St. Louis, 2002-2003

PROFESSIONAL ASSOCIATIONS

Member of the American Finance Association, the American Economic Association, the Western Finance Association, Financial Intermediation Research Society, and the Financial Research Association.

HONORS AND AWARDS

- Winner of Citigroup Award for the best paper at the 2009 Summer Research Conference hosted by The Centre for Analytical Finance (CAF) at the Indian School of Business (ISB)
- Reid Teaching Awards, BSBA 2009, Full-Time MBA 2004, EMBA 22, 23, 24, 25, EMBA-HSM IV, Washington University in St. Louis
- Marcile and James Reid Chair, Washington University in St. Louis, 2002-2003 (In Recognition of Excellence in Teaching by a Junior Faculty Member)
- Indiana University School of Business - MBA Teaching Excellence Award (1994-1995)
- Indiana University Doctoral Student Association - Associate Instructor Teaching Award (1995)
- Beta Gamma Sigma (member since 1996)
- Participant in the FMA Ph.D. Student Consortium (1995)
- Graduated *magna cum laude* from Augustana College (1991)
- Phi Beta Kappa (member since 1991)
- Pi Mu Epsilon Mathematics Honor Society (member since 1990)
- Presidential Scholar at Augustana College (1987-1991)
- GTE Academic All-American Nominee in Track and Field (1991)

PUBLICATIONS

1. "Strategic Flexibility and the Optimality of Pay for Luck", (joint with Radhakrishnan Gopalan and Fenghua Song), *Review of Financial Studies* 23-5, 2060-2098, 2010.

2. "Asymmetric Benchmarking in Compensation: Executives are Paid for Good Luck But Not Punished for Bad", (joint with Gerald Garvey), *Journal of Financial Economics* 82-1, 197-225, October 2006.

3. "Credit Ratings as Coordination Mechanisms", (joint with Arnoud Boot and Anjolein Schmeits), *Review of Financial Studies*, 19-1, 81-118, Spring 2006.

4. "Sunflower Management and Capital Budgeting", (joint with Arnoud Boot and Anjan Thakor), *Journal of Business* 78-2, March 2005, 501-527.

5. "Incentive Compensation When Executives Can Hedge the Market: Evidence of Relative Performance Evaluation in the Cross-Section", (joint with Gerald Garvey), *Journal of Finance* 58-4, 1557-1581, August 2003.

6. "CEO Reputation and Stock-Based Compensation", *Journal of Financial Economics* 68-2, 233-262, 2003.

7. "Managerial Career Concerns and Investments in Information", (joint with Richard Shockley and Anjan Thakor), *Rand Journal of Economics* 32-2, 334-351, 2001.

8. "EVA versus Earnings: Does it Matter Which is More Highly Correlated with Stock Returns", (joint with Gerald Garvey), *Journal of Accounting Research* 38, 209-245, 2000.

9. "Regulation and the Evolution of the Financial Services Industry", (joint with Arnoud Boot and Silva Dezelan), in *Topics in Corporate Finance: Perspectives on the Regulation of the Financial Services Industry*, ed. by Arnoud Boot and Jeroen Ligterink, Amsterdam Center for Corporate Finance Number 2, 25-41, 2000.

10. "The Theory of Security Design", (joint with Arnoud W.A. Boot and Anjan V. Thakor), in *The Handbook of Equity Derivatives*, Second Edition, ed. by Jack Francis, William Toy and J. Gregg Whittaker, Irwin Professional Publishers, 665-687, 2000.

11. "Megamergers and Expanded Scope: Theories of Bank Size and Activity Diversity", (joint with Arnoud Boot and Anjan Thakor), *Journal of Banking and Finance* 23, 195-214, 1999.

12. "Regulatory Distortions in a Competitive Financial Services Industry", (joint with Arnoud Boot and Silva Dezelan), *Journal of Financial Services Research* 16-2/3, 249-259, 1999.

13. "The Search for the Best Financial Performance Measure: Yes, Basics are Better – If You Understand Them", (joint with Jeff Bacidore, John Boquist, and Anjan V. Thakor), *Financial Analysts Journal*, 1999.

14. "How Do You Win the Capital Allocation Game?", (joint with John Boquist and Anjan Thakor), *Sloan Management Review* 39-2, 59-71, 1999.

15. "EVA's Charm as a Performance Measure", in *Mastering Finance*, ed. by George Bickerstaffe, FT Pitman Publishing, 133-138, 1998.

16. "The Search for the Best Financial Performance Measure", (joint with Jeff Bacidore, John Boquist, and Anjan V. Thakor), *Financial Analysts Journal*, May-June, 11-20, 1997.

17. "EVA and Total Quality Management", (joint with Jeff Bacidore, John Boquist, and Anjan Thakor), *Journal of Applied Corporate Finance*, Summer, 81-89, 1997.

PUBLISHED COMMENTS

18. "Comment on Colin Mayer's 'Financial Systems and Corporate Governance' ", *Journal of Institutional and Theoretical Economics* 154-1, 170-176, 1998.

19. "The Winner-Takes-All: An Alternative View of CEO Incentives" (comment on three papers), in *Executive Compensation and Shareholder Value: Theory and Evidence*, ed. by Jennifer Carpenter and David Yermack, Kluwer Academic Publishers, 47-52, 1999.

WORKING PAPERS

20. "How Well Do Investors Process (More Subtle) Information? The Case of Employee Stock Options", (joint with Jian Cai and Gerald Garvey), December 2008.

21. "How did increased competition affect credit ratings?", (joint with Bo Becker), May 13, 2009 (under revision for second round at the *Journal of Financial Economics*).

22. "The Role of Stock Liquidity in Executive Compensation", (joint with Sudarshan Jayaraman), September 23, 2009 (revising to resubmit to *The Accounting Review*).

23. "Inside the CEO Labor Market: The Role of CEO Talent in Pay and Turnover Decisions", (joint with Antonio Falato and Dan Li), working paper, January 2010.

24. "Whistle Blowing and CEO Compensation: The Qui Tam Statute", (joint with Sudarshan Jayaraman), February 9, 2010

BOOKS

25. *The Value Sphere: Secrets of Creating & Retaining Shareholder Wealth*, 4th edition, (written jointly with John A. Boquist and Anjan V. Thakor), World Scientific Publishing, 2000

PAPER PRESENTATIONS AT PROFESSIONAL MEETINGS

- 2008 NBER Corporate Finance Summer Institute
- 2008 UBC Summer Finance Conference
- 2006 WFA Meeting
- 2005 NBER Corporate Finance Summer Institute
- 2004 AFA Meeting
- 2003 WFA Meeting
- 2002 Colorado Summer Finance Conference
- 2000 AFA Meeting
- 1999 CEPR Conference on Core Competencies.
- 1998 WFA Meeting
- 1998 AFE Meeting
- 1998 *JBF* Conference on the Consolidation in Financial Services at the Federal Reserve Bank of New York
- 1998 Conference on Financial Modernization and Regulation, sponsored by the Federal Reserve Banks of Atlanta and San Francisco
- 1997 FMA International Meetings in Zurich.
- 1997 AFA Meeting
- 1997 Econometric Society meetings
- 1997 WFA Meeting
- 1997 CEPR Corporate Finance Workshop (London).
- 1996 WFA Meeting
- 1996 European Finance Association Symposium on Corporate Governance

UNIVERSITY WORKSHOP PRESENTATIONS

Birkbeck College; Boston College; Drexel University; Federal Reserve Bank of New York; Indiana University; INSEAD; Lancaster University; London Business School; London School of Economics; Maastricht University; Michigan State University; Northwestern University; Norwegian School of Management; Oxford University; Southern Methodist University, Stockholm School of Economics; University of Amsterdam; University of Arizona; University of British Columbia; UCLA; University of Chicago; University of Georgia; University of Illinois, University of Iowa, University of Miami; University of Michigan; University of Missouri; UMSL; University of North Carolina; University of Pittsburgh; University of Texas; University of Western Ontario; Vanderbilt University, Washington University in St. Louis; and York University

CONFERENCE PARTICIPATION

Conference Organizer, Washington University Corporate Finance Conference 2004-2009
WFA Program Committee 1999-2009
Financial Research Association (Las Vegas) Program Committee 2004-2009
EFA Program Committee 2007
China International Conference in Finance Program Committee 2007

REFEREEING EXPERIENCE

Serve as an ad hoc referee for *Journal of Finance*; *Review of Financial Studies*; *Journal of Financial Economics*; *American Economic Review*; *Review of Economic Studies*; *Quarterly Journal of Economics; Journal of Economic Theory*; *Rand Journal of Economics*; *Journal of Business*; *Journal of Economics, Management and Strategy*; *Journal of Financial Intermediation*; *Management Science*; *Journal of Banking and Finance*; *Journal of Corporate Finance*; and *European Economic Review.*

DISSERTATION COMMITTEES

Committee Member: Nina Baranchuk, Jian Cai, Jason Smith, Fenghua Song, Rong Wang, Jun Yang, and Chris Yung
Dissertation Co-Chair: Evrim Akdogu
Dissertation Chair: Kangzhen Xie (current student)

SELECTED TEACHING EXPERIENCE

- Fin 448 Advanced Financial Management (BSBA – Fall 2007/2008/2009)
- Fin 5203 Finance Core (MBA – Fall 2007/2008/2009)
- MGMT400X Sports Management (BSBA/MBA – Spring 2008/2009)
- Fin 745 Corporate Financial Strategy (EMBA – Yearly)
- Fin 780 Advanced Topics in Finance (EMBA – Yearly)
- Fin 500I Advanced Corporate Finance III – Frontiers of Valuation (MBA – Summer/Fall 2008)
- Fin 740 Corporate Financial Management (EMBA Shanghai – Yearly)
- Fin 534 Advanced Corporate Finance I – Valuation (MBA)
- Fin 534B Advanced Corporate Finance II – Financing (MBA)
- Fin 523B Mergers & Acquisitions (MBA)

SOME RECENT TEACHING PERFORMANCE

- Fin 500I Advanced Corporate Finance III – Frontiers of Valuation (Full-time MBAs), Fall 2008, Teaching Rating: 9.23/10 (mean), 10/10 (median)
- Fin 745 Corporate Financial Management (Executive MBAs), Winter 2008, Teaching Rating: 9.63/10 (mean), 10/10 (median)
- Fin 780 Advanced Topics in Finance (Executive MBAs), Spring 2007, Teaching Rating: 9.72/10 (mean), 10/10 (median)

SELECTED EXECUTIVE EDUCATION EXPERIENCE

- "Strategic Financial Customer Integration Program" for Nestlé Purina Pet Care
- "Finance and Strategy in the Quest for the Summit" for Centene Corporation
- "Evaluating Projects in Practice – Growing in a Value-Creating Manner" for Metal Service Center Institute (MSCI)
- "Resource Allocation and Shareholder Value" for MSCI
- "Financial Evaluation of Strategies and Decisions" for MSCI
- "Finance for the Non-Financial Manager" (delivered in open-enrolment programs, along with various customized versions for MSCI, Bunge Ltd, Black & Veatch, Sara Lee, TALX, Bell-Bowe-Howell, and Essex Industries)
- "Resource Allocation in Practice" (delivered in open-enrolment programs, along with customized versions for Centene, Sara Lee, Bunge Ltd, Black & Veatch, Whirlpool Corporation, and MSCI)
- "Using Numerical Reasoning To Solve Problems" (delivered to Tyson Foods)
- Delivered ten-week "Financial Core" class to the writers of the *Lex Group* and Senior Editors of the *Financial Times*

SELECTED CONSULTING EXPERIENCE

- Advising on performance measurement and incentive pay for law firms
- Expert witness work for employee compensation issues
- Advising on issues related to valuation and capital structure policies for both investment banks and non-financial firms
- Facilitating the redesign of corporate resource allocation practices and policies within non-financial firms
- Serve on an academic advisory board to a credit rating agency