

1 DAVID R. ZARO (BAR NO. 124334)
2 TED FATES (BAR NO. 227809)
3 KIM A. BUI (BAR NO. 274113)
4 ALLEN MATKINS LECK GAMBLE
5 MALLORY & NATSIS LLP
6 501 West Broadway, 15th Floor
7 San Diego, California 92101-3541
8 Phone: (619) 233-1155
9 Fax: (619) 233-1158
10 E-Mail: dzaro@allenmatkins.com
11 tfates@allenmatkins.com
12 kbui@allenmatkins.com

13 Attorneys for Receiver
14 THOMAS C. HEBRANK

15 **UNITED STATES DISTRICT COURT**
16 **SOUTHERN DISTRICT OF CALIFORNIA**

17 SECURITIES AND EXCHANGE
18 COMMISSION,

19 Plaintiff,

20 v.

21 LOUIS V. SCHOOLER and FIRST
22 FINANCIAL PLANNING
23 CORPORATION d/b/a WESTERN
24 FINANCIAL PLANNING
25 CORPORATION,

26 Defendants.

Case No. 3:12-cv-02164-GPC-JMA

**SUPPLEMENTAL BRIEF/SUR-
REPLY TO DEFENDANTS'
MOTION FOR MODIFICATION TO
THE PRELIMINARY INJUNCTION
ORDER TO REMOVE THE REAL
ESTATE GENERAL
PARTNERSHIPS FROM THE
RECEIVERSHIP**

Date: July 26, 2013
Time: 1:30 p.m.
Ctrm: 9D
Judge: Hon. Gonzalo P. Curiel

**NO ORAL ARGUMENT UNLESS
REQUESTED BY THE COURT**

19
20
21
22
23
24
25
26
27
28

1 Allen Matkins Leck Gamble Mallory & Natsis LLP ("Allen Matkins"),
2 counsel for Thomas C. Hebrank ("Receiver"), Court-appointed receiver for First
3 Financial Planning Corporation d/b/a Western Financial Planning Corporation
4 ("Western"), and its subsidiaries, including the General Partnerships ("GPs") set up
5 by Western (collectively, "Receivership Entities"), hereby submits this Supplemental
6 Brief/Sur-Reply to Defendants' Motion for Modification to the Preliminary
7 Injunction Order to Remove the Real Estate General Partnerships from the
8 Receivership ("Motion").

9 I. INTRODUCTION

10 Defendants have attacked the receivership throughout this case and the Court
11 has repeatedly rejected their arguments. The Court rejected their arguments for
12 dissolving the TRO, rejected their arguments for removing Western from the
13 receivership, rejected their arguments against entry of the Preliminary Injunction
14 Order, and rejected their oppositions to virtually all relief the Receiver has requested.
15 Most recently, the Court denied Defendants' motion to dismiss the complaint.

16 Nevertheless, Defendants continue to pretend: (a) there is no conceivable
17 issue arising from their sale of GP property interests at vastly inflated prices; (b) the
18 Court and the Receiver have no legitimate authority over the Receivership Entities;
19 (c) Mr. Schooler's actions have nothing to do with the financial crisis facing the
20 Receivership Entities or the devastating losses investors will incur; and (d) any
21 deviation from "business as usual" prior to the receivership is immediate grounds to
22 remove the GPs from the receivership. Defendants also continue to pretend, and
23 have misled investors into believing, the Court has not considered and authorized the
24 Receiver's actions. For example, Defendants feign outrage that the Receiver
25 (a) ordered appraisals for each GP property, (b) collected certain loans Western made
26 to the GPs, and (c) caused \$51,000 of Western's equity interests in the GPs to be
27 converted to cash. Of course, Defendants are well aware the Receiver recommended
28 and the Court approved each of these actions.

1 In reality, the Motion is part of a public relations campaign by Defendants
2 directed at investors. Defendants' strident tone, refusal to acknowledge the Court's
3 authority, and arguments that business must be conducted exactly as it was prior to
4 the receivership are designed to play directly to investors' natural tendency not to
5 accept that they may have bought investments worth much less than they believed,
6 lack of familiarity with the complexities of a securities enforcement lawsuit and
7 equity receivership, and susceptibility to misinformation concerning their
8 investments.

9 The investors' letters to the Court reflect a pattern of misinformation. It is
10 evident that investors have been misled into believing the receivership is costing
11 them huge amounts of money¹ and the Receiver is unilaterally taking actions for the
12 GPs, including obtaining appraisals of GP properties² and reducing Western's equity
13 interests in the GPs to cash.³ Mr. Schooler has established a website about the case
14 that makes these same misrepresentations
15 (<http://secvsschooler.com/index.php/investor-newsletters>). This has caused
16 confusion and unrest among investors, as demonstrated by the flood of letters the
17 Court has recently received. Many investor letters quote the misinformation on
18 Mr. Schooler's website and fail to recognize the Court's authority.

19 The real reason the GPs and their investors are in the position they are today is
20 Western took more than \$80 million from the GPs, and Mr. Schooler completely
21

22 ¹ As explained in the Receiver's Response to the Motion, a total of \$51,001 has been
23 used to convert Western's equity interests in the GPs to cash and Western's equity
24 interests in the GPs have been reduced accordingly. This amount was used to help
25 pay Court-approved fees and costs of the Receiver and his professionals for the
26 first 4 months of the case. This works out to approximately \$150 per month per
27 GP.

28 ² The Court expressly authorized the Receiver to obtain appraisals of the GP
properties. Docket No. 59.

³ The Court twice expressly authorized the Receiver to reduce Western's equity
interests in the GPs to cash to the extent Western's liquid assets were insufficient
to pay Court-approved fees and costs of the receivership. Docket Nos. 169 and
190.

1 drained Western of cash, including paying himself more than \$20 million in salaries
2 alone. This made Western entirely dependent on cash infusions from Mr. Schooler
3 and new sales of GP ownership units. When the Receiver was appointed, new sales
4 of GP ownership units immediately ceased. When Mr. Schooler was unsuccessful in
5 having Western removed from the receivership, he stopped putting money back into
6 Western. As a result, Western has run out of cash and is unable to cover GP cash
7 shortfalls and provide the other means of financial support to the GPs that it did prior
8 to the receivership.

9 Many other investors, having read the Receiver's reports, have expressed
10 shock and dismay to learn (a) what Mr. Schooler paid for the land in relation to what
11 he sold it to the GPs, (b) the amount of money Western obtained from the GPs, and
12 (c) the properties' current appraised values. Although these investors may not have
13 written letters to the Court, their interests should be protected, and, as recommended
14 in the Receiver's Real Estate Valuation Report (Docket No. 203), they should have
15 the right to vote whether to cut their investment losses and preserve their claims
16 against the receivership estate or have their GPs retain their property interests in the
17 hope that they rapidly increase in value.

18 II. ARGUMENT

19 A. Mortgage Payments

20 Defendants argue the Receiver is not making payments on loans secured by
21 GP properties in order to accumulate cash in Western's accounts so he can pay
22 himself. This is incorrect. In fact, before Defendants' reply brief was filed, the
23 Receiver's counsel had a telephone call with Defendants' counsel and explained that
24 the Receiver will make as many mortgage payments as possible without putting
25 Western in a position where it has insufficient cash to pay its remaining employees
26 and establish a new work place for the employees when the 5186 Carroll Canyon
27 Road property is sold in August. The Receiver's counsel also gave Defendants'
28 counsel advance notice of his Ex Parte Application for Authority to (A) Sell Office

1 Furniture and Equipment, and (B) Establish New Work Place for Remaining
2 Employees (Docket No. 451), which was then filed by the Receiver on July 23, 2013.
3 Defendants make no mention of this conversation or the Ex Parte Application in their
4 reply brief.

5 The Receiver is currently evaluating Western's cash position and projected
6 expenses and will make loan payments in the coming days once that analysis is
7 complete. Contrary to the arguments in the reply brief, Western does not currently
8 have sufficient cash to make all mortgage payments and pay its basic operating
9 expenses. The Receiver has warned that this would occur on numerous occasions.
10 Nevertheless, the Receiver has made the majority of the loan payments listed on
11 page 14 of the reply brief, with the exception of loans on properties that are
12 underwater and related-party debts that may be disputed.

13 It is important to note that if Mr. Schooler were willing to return some of the
14 more than \$20 million in salaries only he personally obtained from Western or repay
15 some of the loans Western made to the LinMar entities he owns, then Western would
16 be able to make all mortgage payments and the GPs would not be exposed to risks
17 associated with potential loan defaults and/or property tax defaults.

18 Defendants argue that Western's receivables from the GPs exceed its liabilities
19 on loans secured by GP properties, and therefore "simply collecting amounts due"
20 will allow Western to make all mortgage payments. Reply, p. 15. Defendants know
21 this is not the case. To begin with, the Receiver has sought authority to collect the
22 more than \$1.26 million due from the LinMar Borrowers and Defendants have
23 opposed the Receiver's motion. Apparently, "simply collecting amounts due" does
24 not apply to Mr. Schooler.

25 As the Receiver has explained several times, the amount collected from GPs
26 each month, either because investors cannot or are unwilling to pay their notes, is
27 insufficient to make all mortgage payments. This was the case prior to the
28 receivership and one of the reasons Mr. Schooler put more than \$1 million into

1 Western in the eight months leading up to the receivership. Since investors have
2 learned of the Commission's allegations of fraud, even fewer investors are making
3 note payments. In addition, the Receiver's preliminary analysis of land held by
4 Western indicates that the land is underwater and has no current value.

5 **B. Loan Payments from GPs to Western**

6 Defendants list a series of payments made by GPs to Western in repayment of
7 loans Western made to the GPs and suggest that these payments have put the GPs in
8 the position of being unable to pay property taxes. Again, this is incorrect.

9 The Receiver fully disclosed to the Court that he intended to have Western
10 collect certain loans made to GPs. The Receiver explained that before making each
11 loan payment, he analyzed the upcoming expenses of each GP to ensure the loan
12 payments would not put the GP in jeopardy of being unable to meet its financial
13 obligations. Docket Nos. 175 and 176. The Court acknowledged and endorsed these
14 actions in its Order Granting in Part Second Interim Fee Applications. Docket
15 No. 190. The Court also approved the Receiver's recommendation that an appraisal
16 of each GP property be obtained (Docket No. 59) and twice expressly authorized the
17 Receiver to reduce Western's equity interests in the GPs to cash to the extent
18 Western's liquid assets were insufficient to pay Court-approved fees and costs of the
19 receivership (Docket Nos. 169 and 190).

20 The Receiver will ensure that no GP property tax payments due in
21 August 2013 go unpaid because of loan payments made to Western or because
22 Western's equity interests in those GPs were converted to cash as authorized by the
23 Court. Future tax payments will be made based on the Court's rulings on the Real
24 Estate Valuation Report and cash available in GP accounts. The Receiver will also
25 ensure that all property insurance premiums for all properties are paid in full.

26 **C. There is No Conflict of Interest**

27 As another attempt to incite unrest among investors, Defendants speciously
28 argue that the Receiver has a conflict of interest. This argument has no merit.

1 Courts routinely appoint receivers over multiple entities accused of securities
2 violations, particularly where, as here, the entities had pre-receivership transactions
3 between and among them and the entities are part of a larger scheme or enterprise
4 operated by the individual defendants. Appointing separate receivers for each entity
5 is unnecessary and would exponentially increase administrative expenses. Receivers
6 conduct investigations, make recommendations to the Court based on what is best for
7 the receivership estate as a whole, and Courts have broad discretion to accept,
8 modify, or reject those recommendations. Receivers do not advocate for the interests
9 of one entity or group of investors, but for what is best for the entire receivership
10 estate. Courts supervise receiverships to make sure all stakeholders are treated fairly
11 and equitably.

12 Here, the Receiver's objective is to preserve and protect all receivership assets,
13 maximize the recovery for all investors, and if authorized by the Court, distribute
14 assets in a manner that treats all investors fairly and equitably. The Receiver has
15 made recommendations to the Court throughout the case to advance these objectives.
16 If the Court determines that one group of investors is being improperly favored over
17 others or that equity calls for one group of investors to be treated better or worse than
18 another group of investors, then the Court can issue appropriate orders to level the
19 playing field or otherwise ensure a fair and equitable distribution of receivership
20 estate assets.

21 **D. Real Estate Valuation and Proposed Investor Voting**

22 In the Real Estate Valuation Report, the Receiver has proposed a voting
23 process where investors, armed with information including the appraised value of
24 their GP property interests and the projected costs to retain such property interests,
25 can vote whether to (a) sell the property, cut their losses where they stand, and retain
26 their claims against the receivership estate, or (b) retain their property interests,
27
28

1 relinquish their claims against the receivership estate,⁴ take sole responsibility for all
2 mortgages, taxes, and other expenses, and hope that the property interests rapidly
3 increase in value.

4 Becoming a truly independent, stand-alone GP would be a significant change
5 from the pre-receivership situation in which Western financed investor purchases of
6 GP ownership units, made payments on loans secured by GP properties, covered GP
7 cash shortfalls, and purchased GP ownership units from investors who demanded
8 their capital back. Because Western was always there to perform these operations
9 and shore-up capital deficiencies, the GPs had relatively few issues to resolve on
10 their own. If they vote to retain their property interests and take the steps necessary
11 to separate from the receivership estate, they will need to establish new procedures
12 and contingency plans to handle these issues and, most importantly, establish a
13 capital base to support operation of the subject property. If they do not, they will be
14 unable to function, unable to pay their bills, and end up losing everything.

15 Accordingly, it is important that an informed vote be taken, that investors understand
16 the substantial costs and risks, and that investors "buy in" to the ultimate decision.

17 If, on the other hand, there are insufficient votes for certain GPs to retain their
18 property interests, and as a result those property interests are listed for sale, nothing
19 prevents investors who believe those property interests are poised to substantially
20 appreciate in value from organizing a new entity to bid and purchase the property
21 interests from the receivership estate. Investors in GPs that sell their property
22 interests will receive their share of the net sale proceeds and cash on hand in GP
23 accounts according to their GP ownership interests.

24
25
26 ⁴ Claims arise from a right to payment resulting from a loss or damage suffered.
27 Investors in GPs who retain their property interests have no loss or damage, or at
28 least not one that has been realized yet. In order for distributions to be made,
claim amounts must be determined now, as opposed to some undetermined time in
the future when Separating GPs sell their property interests. There would be no
present way to determine the proper amount of claims of investors in Separating
GPs.

1 The Receiver believes these recommendations treat investors fairly and
2 equitably under the circumstances of this case and put an administratively workable
3 and efficient system in place to promptly address the cash crisis currently threatening
4 the GPs and their property interests.

5 **III. CONCLUSION**

6 For the foregoing reasons, the Motion should be denied.

7
8 Dated: July 23, 2013

ALLEN MATKINS LECK GAMBLE
MALLORY & NATSIS LLP

9
10 By: s/Ted Fates

11 TED FATES
12 Attorneys for Receiver
13 THOMAS C. HEBRANK
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28