Eric J. Hougen (SBN 258968)
Law Offices of Eric J. Hougen
624 Broadway, Suite 303
San Diego, CA 92101
Telephone: (619) 702-1000
Facsimile: (619) 702-1005

Philip H. Dyson, Esq. (SBN 097528)
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
(619) 462-3311

Edward Patrick Swan, Jr., Esq. (SBN 089429)
Jones Day
12265 El Camino Real, Suite 200
San Diego, CA 92130
Telephone: (858) 703-3132
Facsimile: (858) 314-1150

Attorneys for Defendants LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING CORPORATION

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING CORPORATION d/b/a WESTERN FINANCIAL PLANNING CORPORATION,

Defendants.

Case No. 12 CV 2164 GPC JMA

DEFENDANTS' RESPONSE TO FOURTH INTERIM APPLICATIONS FOR APPROVAL AND PAYMENT OF FEES AND COSTS (RECEIVER AND COUNSEL)

Date: November 8, 2013
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

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CASES

Defendants LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING CORPORATION (collectively "Defendants") respond as follows to the Fourth Interim Applications for Approval and Payment of Fees and Costs to the Court's appointed receiver, Thomas C. Hebrank, CPA ("Receiver"), and the Receiver's counsel, Allen Matkins Leck Gamble Mallory & Natsis LLP ("Receiver's Counsel").

I.

INTRODUCTION

The Receiver, on behalf of himself and Receiver's Counsel, has filed three interim applications for payment of fees and costs involving the continued receivership of Western Financial Planning Corporation ("Western") and the real estate general partnerships ("GPs") for the period of April 1, 2013 through June 30, 2013.[1]

The Receiver and Receiver's Counsel claim to have incurred a total of $149,013.01 in fees and costs for work performed for those three months, with $102,693.60 in fees and $790.37 in costs for the Receiver, and $44,496.00 in fees and $1,033.04 in costs for Receiver's Counsel. *See* Dkt. No. 479, p. 2 of 3. These fees are calculated after a 10% fee discount for the Receiver. Dkt. No. 477, 2:15-16.

Defendants object to the Fourth Interim Applications on several grounds. First, during the time period at issue, the Receiver, despite having available cash in Western's bank account, stopped making payments on the seller-financing carryback notes that Western owes to the original sellers of the GP-owned properties (the "Underlying Notes"). Therefore, as with the Third Fee Applications, ***the***

[1] The hearing on November 8, 2013 will also include the final fee application for Cotton, Driggs, Walch, Holley Woloson & Thompson, Special Counsel to the Receiver for eminent domain litigation in Nevada that involved a partial taking of a parcel held by four GPs. The eminent domain litigation predated this litigation and appointment of the Receiver; Defendants do not object to that fee application.

Receiver must be required to certify to the Court that all Underlying Notes are current before the Court approves any portion of the Third Fee Applications. The Receiver had the GPs continue to pay their GP note obligations to Western, but then ***did not*** use that cash to pay the corresponding Underlying Note obligations. That caused cash to accumulate in Western's account – cash that will undoubtedly be used by the Receiver to pay his fees upon approval of the Fourth Fee Applications.[2]

The money that the GPs have paid to Western on the GP Notes has been paid with the express understanding and obligation, under the all-inclusive deed of trust, that Western will apply those funds directly to the corresponding Underlying Notes. The Court must not allow the Receiver to divert those funds to payment of his own fees. The Receiver's duty of care to the receivership entities requires that available cash be used to pay existing obligations. The Court must not allow the Receiver to prioritize his fees ahead of existing secured obligations, the nonpayment of which not only breaches the Receiver's duty of care to the receivership entities, but puts the GPs' title interests at risk.

Second, even if the Underlying Notes are brought current by the Receiver and remain current, the fees and costs to be recovered by the Receiver continue to be

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[2] As of the date of this Opposition, the Receiver has refused to pay the scheduled payments for August 2013 and September 2013 on the Underlying Notes, despite sufficient cash on hand. Defendants' attorneys have requested an explanation from the Receiver's counsel in writing, but have received no response whatsoever. The Receiver has furthermore attempted to thwart investors and Defendants from contacting beneficiaries of the Underlying Notes to confirm that payments have been made.

Despite the Receiver's interference, Mr. Schooler's staff has been able to contact seven of the beneficiaries on the Underlying Notes, all of whom have reported that their loans are in default with payments or late fees still outstanding for August 2013. Three of the beneficiaries have mailed Notices of Default (NODs) but have not yet recorded NODs against the GPs' titles yet. Needless to say, the Receiver's behavior is an extraordinary abuse of discretion and merits nothing but his removal from control of Western for dereliction of duty, without any payment of fees.

unreasonable and excessive in light of the lack of benefit to the receivership entities and the evidence that the Receiver's actions have unnecessarily caused actual harm to the receivership entities. For example, the Receiver has prioritized repayment of lowest-priority unsecured, non-recourse debt ahead of higher-priority secured debt, placing numerous GPs in the position of having insufficient funds to make their next property tax payment – GPs that would have enough cash for their next tax payment ***but for the actions of the Receiver***. The Receiver must not be compensated until the situation of these GPs has been rectified. The Receiver cannot be allowed to be paid for actions that are a direct breach of his duty of care to the receivership entities.

Third, the Receiver should not be allowed to invade GP-owned funds to pay obligations that the Receiver clearly considers to be those of Western. The GPs are separate and distinct legal entities, as the Court has acknowledged in its order dissolving the receivership over them (Dkt. No. 470), and the Receiver's use of GP funds to pay obligations the Receiver considers to be those of Western must stop.

The Receiver must not be allowed to force the GPs, without input from the investors, to continue to use GP operating capital (deposited by investors with the express intent that those funds would be used to pay taxes and insurance) to repurchase Western's GP units, whether to pay his own fees or to liquidate Western's equity holdings.

Therefore, Defendants request that the Fourth Interim Applications be ***denied***. In the alternative, to the extent the Court decides to approve any portion of the Fourth Interim Applications, the Receiver must first be required (1) to bring the Underlying Notes current and keep them current, and (2) to reverse the payments he has forced the GPs to make on their lowest priority unsecured debt – the loans from Western to the GPs for payment of property taxes, etc., the forced repayment of which is done solely to provide a source of payment for the Receiver - before the Receiver is allowed to collect on any fees identified in the Fourth Interim

Applications.

II.

ARGUMENT

A. THE FEE APPLICATION MUST NOT BE APPROVED UNLESS AND UNTIL THE RECEIVER CERTIFIES THAT HE HAS APPLIED ALL FUNDS RECEIVED FROM THE GPs TO THE CORRESPONDING UNDERLYING NOTES OWED BY WESTERN TO THE ORIGINAL SELLERS

Beginning in late May 2013, during the time period that is the subject of the Fourth Fee Application, the Receiver stopped making payments on Western's behalf for the Underlying Notes. *See* Dkt. No. 407, p. 17 of 27 (listing payments not made by Receiver, which were due in June and early July 2013). The money that the GPs provided to Western as payment for the GPs' notes to Western, which would otherwise have been applied by Western as payments on the Underlying Notes, accumulated in Western's accounts, presumably as a source of funds for the Receiver and his counsel to tap if the Third – and now Fourth - Fee Applications are granted.

The Receiver's failure to pay the Underlying Notes from Western to the original sellers caused harm to the GP investors, since the GPs parted with the cash in their accounts to Western without receiving the corresponding benefit of Western's payment on the underlying obligation. The GPs suffered a double negative impact by being deprived of cash even as their title was placed in jeopardy without corrective action. *See* Dkt. No. 407, p. 20 of 27.

The Receiver claimed – incorrectly - that he did not make the payments because (a) there is a limited amount of cash and (b) he needs the funds to pay Western's employees and pay the other expenses associated with the proposed move of Western's operations. *See* Dkt. No. 455, p. 9 of 14, ll. 7-9 ("Western does not currently have enough cash to make all mortgage payments and pay its basic

operating expenses").[3] What the Receiver failed, and continues to fail, to understand is that the funds he has collected into Western's bank account from the GPs has been paid by the GPs to Western with the express understanding as detailed under the all-inclusive trust deed ("the "AITD") that Western will apply those funds to the corresponding Underlying Note. For the Receiver to collect from the GPs, but then use those funds for purposes other than payment of the Underlying Notes is a breach of his duty of care to the GPs.

Despite the discretion afforded to receivers, they are still bound by the limits of the law and the duties of care owed to the receivership entities. The Receiver owes a duty of care to the GPs while the GPs remain under receivership. When he makes the GP Note payments on behalf of the GPs, he knows the GPs expect a corresponding payment from Western on the Underlying Notes. The Receiver's diversion of those funds to other uses, such as paying his fees or his counsel's fees or covering Western's operational expenses, is not permitted. The Receiver is obligated to apply those funds to the Underlying Notes ahead of everything else.

The duty of care the Receiver owes to the GPs requires it and the duty of care he owes to Western requires it. He breaches his duty to the GPs in that they are deprived of cash without receiving the corresponding benefit to which they are entitled. He breaches his duty to Western in that he causes a default on a secured debt when there is available cash and no higher priority payment obligation required.

On July 18, 2013, Defendants' counsel sent a letter to the Receiver's Counsel advising that the Receiver had failed to make payments on the Underlying Notes that were due in June and July 2013. *See* Dkt. No. 463-1 (declaration of Philip H. Dyson), ¶ 3. In response to the letter, the Receiver's Counsel called Philip H.

[3] The Receiver's statements are false because Western has only one part-time employee (the GP secretaries being independent contractors) and because Schooler, not Western, paid the costs associated with the move of the offices.

Dyson, co-counsel for Defendants, on the afternoon of Friday, July 19, 2013. Dkt. No. 463-1, ¶ 4. During the phone conversation, the Receiver's Counsel stated that the reasons for the non-payment of the Underlying Notes were that "there is a small amount of cash, and he [the Receiver] needs monies to pay employees and pay whatever expenses there are in moving," a reference to the pending sale of the building housing Western's and the GPs' offices and the relocation of the staff. Dkt. No. 463-1, ¶ 4. The Receiver's Counsel then stated that the Receiver was working on a cash-flow analysis and would know by the following Monday (July 22, 2013) what payments the Receiver was going to make. Dkt. No. 463-1, ¶ 5.

The Receiver did not provide any cash-flow analysis or list of payments by July 22, 2013, but instead filed a Surreply to Defendants' Motion for Modification of Preliminary Injunction in which he claimed he had made "the majority of the loan payments" listed in Defendants' Reply - but without specifying which payments were made and when. *See* Dkt. No. 455, p. 9 of 14, ll. 10-12; Dkt. No. 463-1, ¶ 7. The Receiver still claims that he "has managed to continue to make payments on mortgages secured by GP properties and will continue to make all such payments as cash is available." Nevertheless, as of this date – three months later - the Receiver has yet to provide any cash-flow analysis or list of payments.

Such blithe unsupported assertions lack substance. The Receiver needs to be required to present a full accounting demonstrating the current payments on all Underlying Notes before any consideration should be given to his pending fee applications. To date, he has not provided one. Unless and until such a showing has been made, the Fourth Fee Applications should be denied.

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B. THE RECEIVER'S FEE APPLICATION SHOULD BE DENIED IN LIGHT OF THE ACTUAL HARM THAT HAS BEEN CAUSED TO DATE TO THE RECEIVERSHIP ENTITIES BY THE RECEIVER'S ACTIONS, INCLUDING THAT HARM CAUSED DURING THE TIME PERIOD OF THE FOURTH FEE APPLICATION

As set forth in detail in Section E of Defendants' Reply to the Receiver's and the Securities and Exchange Commission's Oppositions to Motion for Modification of the Preliminary Injunction Order to Remove the Real Estate General Partnerships (Dkt. No. 407, pp. 19-27), the Receiver's actions during April, May, and June 2013 have unnecessarily caused actual harm to the receivership entities. In addition to not paying the Underlying Notes, as discussed above in Section A, the Receiver has breached the duty of care owed to the GPs, inflicting unnecessary harm in multiple ways.

During the period covered in the Fourth Fee Application, the Receiver has used GP operating capital that was deposited by the investors for the express purpose of paying property taxes and insurance to instead repay unsecured, non-recourse notes to Western. As identified in the list set forth below, which is derived from Exhibit A of Dkt. No. 481 (the Receiver's Fifth Interim Report), there are nine GPs that as of June 30, 2013 would have had enough money to make their next property tax payment except for the fact that the Receiver used limited available cash to repay the unsecured debt owed to Western instead of preserving that cash for the next tax payment, while simultaneously halting collection for operating expenses. For example:

1. $11,731 was paid from BLA Partners to Western, leaving only $899.76 in the BLA Partners bank account.
2. $7,799 was paid from Borderland Partners to Western, leaving only $183.67 in the Borderland Partners bank account.
3. $6,399 was paid from Honey Springs Partners to Western, leaving only $86.41 in the Honey Springs Partners bank account.
4. $4,516 was paid from Horizon Partners to Western, leaving only $183.04

in the BLA Partners bank account.

5. $7,478 was paid from Production Partners to Western, leaving only $127.70 in the Production Partners bank account.
6. $7,690 was paid from Rainbow Partners to Western, leaving only $155.55 in the Rainbow Partners bank account.
7. $4,320 was paid from Suntec Partners to Western, leaving only $150.59 in the Suntec Partners bank account.
8. $7,210 was paid from Victory Lap Partners to Western, leaving only $127.65 in the Victory Lap Partners bank account.
9. $4,320 was paid from Valley Vista Partners to Western, leaving only $416.95 in the Valley Vista Partners bank account.

To be clear: Nine GPs do not have enough money to make their next property tax payment for no other reason than the decision by the Receiver to inexplicably prioritize unsecured debt ahead of pending property tax payments. Without corrective action, these nine GPs will not be able to make their tax payment, unnecessarily incurring late fees and penalties.

During the period of April-June 2013, the Receiver further exacerbated this problem by unilaterally deciding to suspend all operation billing. Normally, the GPs have conducted operational billing to replenish GP operating funds when necessary. The Receiver caused the depletion of funds and has yet to take action to replenish those funds, despite being ordered to do so by the Court in its August 16, 2013 Order. If these GPs miss their tax payments and are assessed late fees and penalties it will be only due to the Receiver's breach of his duty owed to those GPs.

In addition to the nine GPs listed above, seven other GPs (Free Trade, Hidden Hills, International, Lyons Valley, Park Vegas, Prosperity, Via 188) have seen their bank accounts dwindle to under $2,000 each during that period, in large part due to the suspension of billing. *See* Dkt. No. 481, Exh. A.

The Receiver must not be permitted to be paid for such actions directly contrary to the interests of the entities he has a duty to protect.

There are a total of 25 GPs with current bank balances below $5000 as of June 30, 2013, meaning each of these is in need of operational billing or they too are

in danger of not making their next tax payments. The Receiver should not be allowed to pay the fees for himself and his counsel at the same time that he is creating a cash flow problem for the entities in his care. Operational billing has been ordered by the Court to resume immediately.

The Receiver should not be allowed to collect any fees until all corrective action is taken to reverse the unnecessary damage caused by the Receiver's actions to date.

C. THE RECEIVER MUST NO LONGER BE ALLOWED TO FORCE THE GPs TO PURCHASE WESTERN'S GP UNITS

To date, the Receiver has caused the GPs to use $51,000 of GP operating capital designated for property taxes and insurance to be used instead to purchase 51,000 units from Western. This was done without any authority from the investors who deposited that money into the GP operating account and who have the right to vote on any transactions not identified in their respective General Partnership Agreements. The Receiver should not be allowed to force the GPs to enter into any such transaction, especially in light of the Court's Order of August 16, 2013 to dissolve the receivership over the GPs (Dkt. No. 470).

The Receiver must not be allowed to continue to deprive the GPs of their operating capital at a time when the dissolution of the receivership over the GPs is in limbo pending this Court's final rulings on the Receiver's proposed Information Packet. *See* Dkt. No. 484. To the extent the Court approves any portion of the pending fee application, the Receiver must be ordered to stop forcing the GPs to purchase any GP units from Western.

The well-established law in the Ninth Circuit and elsewhere holds that before a third party's property can be included in a receivership -- much less liquidated by that receiver through the forced buyout of another's interests or other property -- the party is entitled to a formal hearing before the court, as the SEC even acknowledged (and promised) at the beginning of this litigation. Dkt. No. 3-1, p. 31 of 33 ("a

district court has the power to include the property of a non-party limited partnership in an SEC receivership order as long as the non-party meets the minimum contact standard ... and receives actual notice and an opportunity for a hearing" (quoting *In re San Vicente Med. Partners Ltd.*, 962 F.2d 1402, 1408 (9th Cir. 1992) (emphasis added)); see *San Vicente*, 962 F.2d at 1407 ("The Constitution requires that property owners receive procedural due process in the form of notice and opportunity for a hearing.") (emphasis added) (citing *Goss v. Lopez*, 419 U.S. 565, 577-79 (1975) ("deprivation of life, liberty, or property by adjudication [must] be preceded by notice and opportunity for hearing appropriate to the nature of the case") (emphasis added, citations and quotations omitted).

This Court has acknowledged that the investors have not had a full opportunity to be heard regarding the GPs' inclusion in the receivership. Dkt. No. 470, 22:2-3. The Court also stated that the dissolution of the receivership would ameliorate the investors' due process issues, through releasing the GPs before their primary investment could be affected. Dkt. No. 470, 22:7-10.

Given that the GPs are to be freed, the Receiver should not be allowed any parting gift of forcing the GPs to buy out Western. The Receiver's actions are akin to an evicted tenant ripping out the appliances and fixtures before the sheriff comes to remove him from the property.

The Receiver's Fourth Fee Application continues to demonstrate that the only people benefitted by the continued existence of the Receivership are the Receiver and Receiver's Counsel, not the GP investors who will now be stuck having to buy out Western's entire equity as a condition of freedom from the Receiver. The same due process that requires the GPs to be removed from the Receivership per the Court's August 16, 2013 Order is the same due process that does not permit the Court to force the GPs to use their hard earned cash to repurchase Western's units. Due process requirements simply leave this Court without adequate authority over the GPs and/or their assets. The Receiver's Fourth Fee Application should be

denied.

D. THE FEES AND COSTS CLAIMED ARE STILL UNREASONABLE WHEN COMPARED TO THE RESULTS

Upon applying the factors of *SEC v. Fifth Avenue Coach Lines,* 364 F.Supp. 1220, 1222 (S.D.N.Y. 1973) to the fee applications, there are many areas in which the applications fall short. There is no great complexity of problems faced, and the benefit to the receivership estate is increasingly nonexistent; as stated above and at length in other documents, the Receiver's continued existence is highly detrimental. *See* Dkt. Nos. 195, 205, 407. The Court has ultimately agreed, since the receivership over the GPs has now been dissolved. Dkt. No. 470.

The problems faced were not truly complex at the beginning of the receivership and did not grow more complex during the spring and early summer of 2013 (and have not grown more complex since). Although there are and were over 100 entities each with its own bank account, 22 properties, and over 3,300 investors, the accounts in that period remained with the same bank as before, the entities remained in their common office in San Diego with common storage, and the entities continued to hold only raw land with no day-to-day management required.

As had historically been the case, the GPs have been able to meet all of their obligations for years at the nominal cost of between $100 and $400 per month, and these obligations and needs did not suddenly increase upon the appointment of a receiver. The GPs' needs had been and remained extremely basic during April, May, and June, and remain so to this day.

The GPs themselves have never been accused of any wrongdoing; they are not parties to this case. There has been no finding, nor even an allegation, of operational wrongdoing or ongoing mismanagement. The only allegations made to date pertain to isolated issues relevant to the offering process. The actual ongoing operation of the GPs has been found to be "accurate and reliable".

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The Receiver owes an obligation to the receivership entities to preserve their assets and to adequately justify any amounts paid to himself out of their accounts, yet he has not explained what value he has provided to the GPs in return.

As noted above, the Receiver, in his Appraisal Report, stated that he had stopped sending bills to the GP investor-partners for GP expenses such as payments on promissory notes for the properties held by the GPs, property taxes, and insurance premiums. Dkt. No. 203, p. 15 of 17. And, as also noted above, the Receiver has failed to pay the Underlying Notes. In one instance (the Dayton II property, held by the Storey County, Comstock, Silver City, and Nevada View GPs), the Receiver's decision to stop collecting operational funds and failure to pay the Underlying Notes has resulted in the property being at risk of default and foreclosure for failure to make the 120th and final underlying note payment.

The Receiver's decisions – which were made with no input from and no formal vote taken of the GP investor-partners – have put the GPs' titles at unnecessary risk. How then can the Receiver be deemed to have provided value to the GPs or their investors?

The GP accounts' money is that of the individual investors comprising each GP. The Receiver has an obligation to examine how best to preserve the assets of the entities in his receivership, pending his (hopefully imminent) removal, not to deplete their accounts without the entities even having a chance to be heard.

The court is not "required to fix fees in total disregard of the fact that this receivership produced a very lean harvest, that all interests suffered heavily, and that the whole enterprise was not a success." *Specialty Products Co. v. Universal Indus. Corp.*, 21 F.Supp. 92, 94 (M.D. Pa. 1937). With the GPs now being tasked with buying out Western as a condition of the elimination of the receivership, the harvest is lean at best, and at worst has been entirely gobbled, locust-like, by the Receiver. All interests will continue to suffer heavily as a result of the Receiver being placed over the GPs without their input or consent, even after the Receiver's removal.

The result obtained by the Receiver is a critical factor. *SEC v. Elliott*, 953 F.2d 1560, 1577 (11th Cir. 1992); *United States v. Code Products Corp.*, 362 F.2d 669, 673 (3d Cir. 1966). Since there has been no indication as to the results obtained through the Receiver's labors to date, the Receiver's work "merits an 'incomplete' grade" and therefore the fee application should be denied in its entirety or else the award should be reduced significantly. *In re Alpha Telcom, Inc.*, 2006 U.S. Dist. LEXIS 79997 at *16 (D. Or. Oct. 27, 2006).

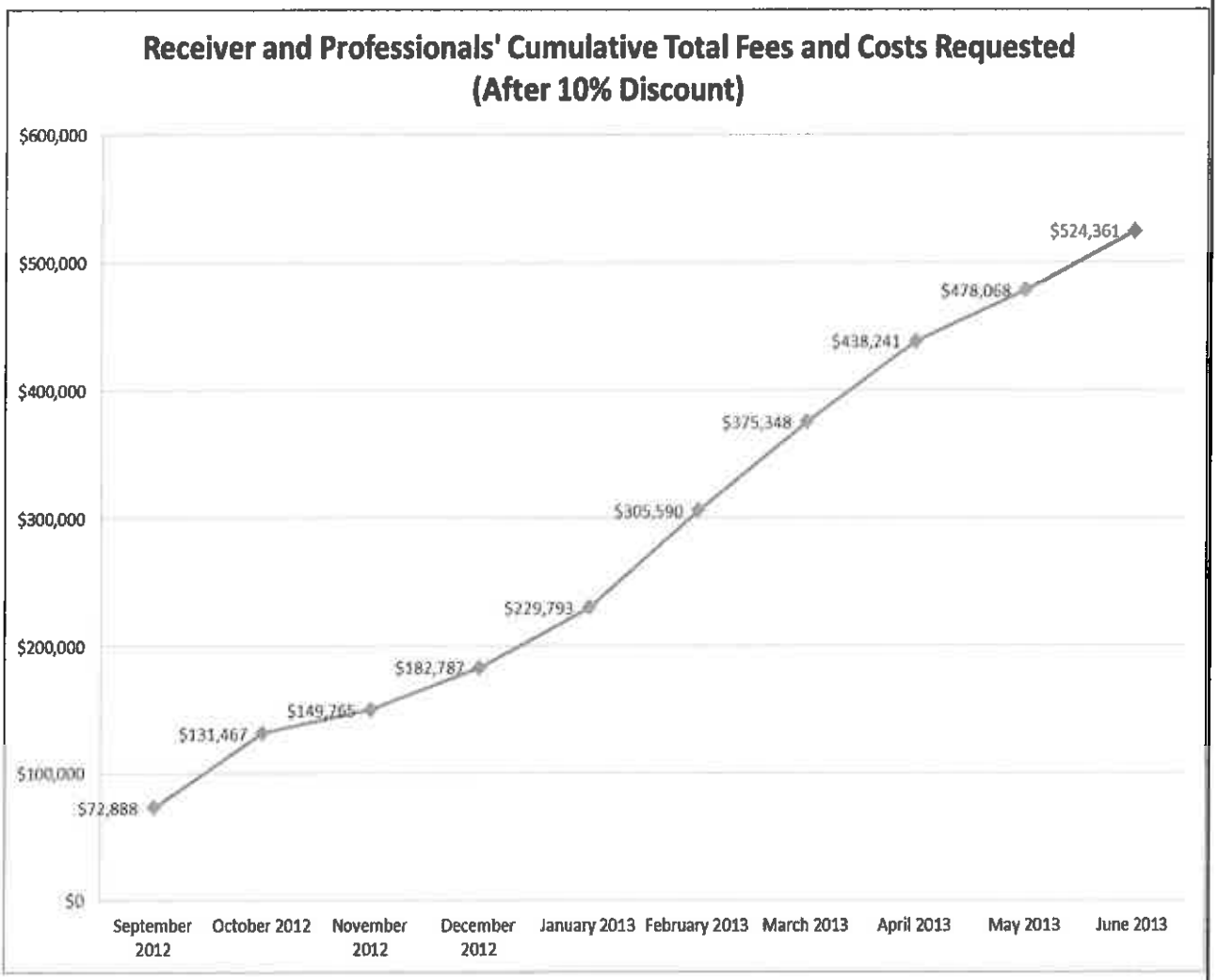
At a minimum, the Receiver should not be allowed to use GP funds, whether directly or through the purchase of Western's equity interests, to pay himself for fees he characterizes as belonging to *Western*, an entity that this Court has acknowledged is separate, distinct, and independent from the GPs.

III.

CONCLUSION

The Fourth Application for fees and costs requested by the Receiver and Receiver's Counsel should be denied. The requested fees and costs are unreasonable. There is no showing as to how the work performed between April 1, 2013 and June 30, 2013 has benefitted Western or the GP's. In fact, there is greater evidence that the actions taken by the Receiver during that period, such as the nonpayment of the Underlying Notes, causing many Underlying Notes to go into default, depleting available funds for lowest priority unsecured debt when existing secured debt obligations remain unpaid, and the decision to stop operational billing of the GP investors, have caused tangible, measurable harm to the receivership entities. The Receiver should not be allowed to collect his fees when he has in fact breached the duty of care he owes to the receivership entities.

To date, even with a 10% discount by the Receiver, the Receiver's Fee Applications have requested a total of almost $525,000 for a total of nine months' work, as shown in the graph below that is derived from the figures in all four fee applications for the Receiver, Receiver's Counsel, and TERIS:



For all of the reasons set forth above, Defendants request that the Fourth Interim Applications be ***denied***. In the alternative, to the extent the Court decides to approve any portion of the Fourth Interim Applications, the Receiver must first be required (1) to bring the Underlying Notes current and keep them current, and (2) to reverse the payments he has forced the GPs to make on their lowest priority unsecured debt, before the Receiver is allowed to collect on any fees identified in the Fourth Interim Applications.

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DATE: October 25, 2013

Respectfully submitted,

/s/Philip H. Dyson

Philip H. Dyson, Esq. (SBN 097528)
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942

Counsel for Defendants

CERTIFICATION

I hereby certify that on the 25th day of October 2013, I electronically filed the foregoing with the Clerk of the District Court using the CM/ECF system, which sent notification of such filing to the following counsels of record:

Sam S. Puathasnanon, Esq.
Sara D. Kalin, Esq.
Securities and Exchange Commission
5670 Wilshire Boulevard, 11th Floor
Los Angeles, CA 90036

Ted Fates, Esq.
Allen Matkins Leck Gamble Mallory & Natsis LLP
501 West Broadway, 15th Floor
San Diego, CA 92101

/s/Philip H. Dyson
Philip H. Dyson