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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

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

Defendants.

Case No. 12 CV 2164 GPC JMA

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S BRIEF IN RESPONSE TO THE COURT'S APRIL 25, 2014 ORDER RECONSIDERING ITS AUGUST 16, 2013 ORDER

Date: July 18, 2014
Time: 1:30 p.m.
Place: Courtroom 2D
Judge: Hon. Gonzalo P. Curiel

Plaintiff Securities and Exchange Commission ("SEC") files this brief to address the issues raised by the Court, *sua sponte*, in its April 25, 2014 Order concerning the parties' motions for partial summary judgment. As directed by the Court, this brief will address (1) the impact of the parties' cross-appeals on the Court's desire to reconsider its order modifying the preliminary injunction to remove the GPs from the receivership (the "August 16 Order"), (2) whether the Court should reconsider its August 16 Order, and (3) the need to provide investors with an opportunity to file briefs and appear at the July 18, 2014 hearing on this matter.

In summary and in response to these issues, (1) Rule 62.1 of the Federal Rules of Civil Procedure permits the Court to advise the Ninth Circuit through an indicative ruling that the Court would reconsider its August 16 Order if asked to do so, (2) the Court has a legal and factual basis for reconsidering its August 16 Order, and (3) the Court should provide investors with an opportunity to file briefs and appear at the July 18 hearing.

I. THE PARTIES' CROSS-APPEALS DO NOT PREVENT THE COURT FROM RECONSIDERING THE AUGUST 16 ORDER

Rule 62.1 of the Federal Rules of Civil Procedure, captioned "Relief Pending Appeal," provides a mechanism, called an indicative ruling, by which the Court can reconsider its August 16 Order. Ordinarily, "[t]he filing of a notice of appeal . . . confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal." *Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56, 58 (1982). As a result, "[a] district court lacks jurisdiction to modify an injunction once it has been appealed except to maintain the status quo among the parties." *Prudential Real Estate Affiliates, Inc. v. PPR Realty, Inc.*, 204 F.3d 867, 880 (9th Cir. 2000). Thus, the Court currently lacks jurisdiction to modify its August 16 Order. But Rule 62.1 states that if "a timely motion is made for relief that the court lacks authority to grant because of an appeal that has been docketed or is pending, the court may: . . . (3) state either that it would grant the

motion if the court of appeals remands for purpose or that the motion raises a substantial issue." FED. R. CIV. PRO 62.1(a)(3). Such a statement is commonly called an indicative ruling. *See* FED. R. CIV. PRO 62.1 Advisory Committee Notes. An indicative ruling is intended exactly for the situation currently before the Court, which has raised a motion for reconsideration *sua sponte*. "This clear procedure is helpful whenever relief is sought from an order that the court cannot reconsider because the order is the subject of a pending appeal." *Id*.; *see also In re DirecTV Early Cancellation Fee Mktg. & Sales Practices Litig.*, 810 F. Supp. 2d 1060, 1066 (C.D. Cal. 2011), *rejected on other grounds by Kilgore v. KeyBank, Nat'l Ass'n*, 673 F.3d 947 (9th Cir.2012) (issuing indicative ruling that substantial issues were raised by parties' motion for reconsideration where court lacked authority to rule because of pending appeal).

Applying Rule 62.1 here, the Court can hear and consider argument from the parties about whether the Court should reconsider its August 16 Order modifying the preliminary injunction and removing the GPs from the receivership. The Court should then determine whether, if the Ninth Circuit remands for reconsideration, the Court would vacate or reverse the August 16 Order and deny defendants' motion for modification, thereby maintaining the GPs in the receivership. *See* FED. R. CIV. PRO 62.1 advisory committee notes. If the Court would do so, it should then issue an indicative ruling stating as much. That ruling should "frame the issue in a way that enables the court of appeals to decide whether to proceed with the appeal or to remand for further district-court proceedings." 16 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 3912.4 (3d ed. 2014). And if the Court does issue an indicative ruling, to ensure proper coordination of the proceedings between the Court and the Ninth Circuit, the Ninth Circuit clerk should be informed of the indicative ruling pursuant to Rule 12.1 of the Federal Rules of Appellate

Procedure. *See* FED. R. CIV. PRO 62.1 advisory committee notes.[1]

II. THE COURT SHOULD RECONSIDER ITS AUGUST 16 ORDER AND MAINTAIN THE GPS IN THE RECEIVERSHIP

Because there is both a legal and factual basis for keeping the GPs in the receivership, the Court should reconsider its August 16 Order.

A. The Legal Basis For Including The GPs In The Receivership

Notice to a defendant that controls property nominally owned by a non-party is sufficient to bring that property within the scope of a receivership, as long as the nominal owners are later given notice and the opportunity for a hearing prior to any material deprivation of a property interest. *See generally SEC v. Am. Principals Holding, Inc.* (*In re San Vicente Med. Partners Ltd.*), 962 F.2d 1402, 1406-08 (9th Cir. 1992) ("*San Vicente*"). As noted in the Court's August 16 Order, a district court may exercise quasi in rem jurisdiction and include in a receivership all property in a defendant's possession or control, even if such property is nominally owned by non-parties to the action (such as the GPs here). *See San Vicente*, 962 F.2d at 1406-07. In that context, "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 contacts standard . . . and [at a later point] receives actual notice and an opportunity for a hearing." *Id.* at 1408. The precise timing of such a hearing is not critical, so long as the opportunity for a hearing is "available before any material deprivation of a property interest occur[s]."[2] *Id.* at 1407. On that basis, the Ninth

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[1] On April 30, 2014, five days after the Court's order directing the parties to file briefs concerning reconsideration, the Ninth Circuit set the cross-appeals for oral argument on July 11, 2014. Because the Court has set the reconsideration matter for hearing on July 18, 2014, the SEC's appellate counsel has filed with the Ninth Circuit a motion to stay the cross-appeals pending this Court's reconsideration of its August 16 Order.

[2] As discussed in Section III, *supra*, by statute, investors would receive a hearing before any deprivation of their property interest through a sale. *See SEC v. American Capital Investments, Inc.*, 98 F.3d 1133, 1137 (9th Cir. 1996).

Circuit in *San Vicente* sustained the district court's authority to include in a receivership a non-party limited partnership controlled by the named defendant (through the defendant's subsidiary, which was the general partner), and also found that the provision of notice and opportunity for a hearing to the named defendant (and its subsidiary) sufficed to provide the same to the non-party partnership as well. *See id*. at 1407-08.

Here, Schooler and Western were named as defendants in the SEC's action and received actual notice and an opportunity to be heard prior to the issuance of the preliminary injunction maintaining the receivership over the GPs. The GPs' original inclusion in the receivership was therefore proper in light of the district court's determination that the SEC had established a *prima facie* case that the GPs were dependent on defendants' managerial control. *See* Dkt. 44, pp. 21-22. Further, the investors who were the purported partners satisfied the minimum contacts standard, received actual notice of the receivership at the time the preliminary injunction ("PI") was entered (Dkt. 49, p. 10), and have been given the opportunity to raise objections throughout the litigation. *See SEC v. Wencke*, 783 F.2d 829, 837-38 (9th Cir. 1986) (rejecting due process claim where prejudice not shown).

B. The Factual Basis For Including The GPs In The Receivership

The Court's determination in its preliminary injunction order ("PI Order") that the SEC had established a *prima facie* case that the GP interests were investment contracts, under the third *Williamson* factor, was sufficient to establish that the GPs, and their property, were under the control of defendants. In its PI Order, the Court recognized that undivided ownership of a property among partnerships, while an overall manager performs property-wide functions, gives rise to a relationship of managerial reliance by investors (i.e., control by the promoter) sufficient as a matter of law to establish the existence of an investment contract.[3] *See* Dkt. 44, pp. 20-22.

[3] Since the entry of the PI Order, the SEC has submitted additional evidence to the

The fact that the GP interests were investment contracts meant that investors were more like limited partners or shareholders in a corporation, and the managerial/ entrepreneurial aspects of the business were controlled by persons other than the investors. *Cf. United Housing Found. v. Forman*, 421 U.S. 837, 852 (1975). Thus, the Court's initial decision to include the GPs in the receivership was proper. *See SEC v. Am. Principals Holding, Inc.* (*In re San Vicente Med. Partners Ltd.*), 962 F.2d 1402, 1406-08 (9th Cir. 1992) ("*San Vicente*").

Defendants argued, months later, that the PI should be modified because the GPs were actually independent entities. Their motion, however, did not cite any new evidence or change in law to overcome the SEC's *prima facie* case on the investment contract issue.[4] *See* Dkt. 195-1, pp. 4-5, 12-17. In fact, defendants have acknowledged and conceded certain facts that reinforce the SEC's *prima facie* case. They conceded that unanimity among co-tenant GPs was required to take action on properties in which they owned fractional interests. *See* Dkt. 462, pp. 17-18. They conceded that the unanimity requirement was unworkable in practice and would paralyze decision-making among co-tenant GPs. *See* Dkt. 210, pp. 6-7 & n.2. And they conceded that there was no evidence that investors would be able to manage their properties without the aid of defendants (or the receiver in their place) or that investors had done so in the past without defendants' managerial efforts. *See* Dkt. 462, pp. 20-21. Nonetheless, the Court ordered the release of the GPs from the receivership based on its view that the GPs could operate as independent entities

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Court further demonstrating the investors' dependence on defendants under the third *Williamson* factor. *See* Dkt. 563-1, pp. 17-25.

[4] Because defendants presented no new evidence to rebut the SEC's *prima facie* case on the investment contract issue, the Court could have treated defendants' motion for modification as a motion for reconsideration of the PI under Rule 59(e) of the Federal Rules of Civil Procedure. *See Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1123-25 (9th Cir. 2005) (motion for modification should be treated as motion for reconsideration if no new facts presented).

because they required only minimal administrative operations.[5] *See* Dkt. p. 25. This ruling, however, did not expressly address the impact of the unanimity requirement on the GPs' ability to operate independently or defendants' concession that the co-tenancy arrangement was unworkable. In any event, the Court has now ruled, in its April 25, 2014 order granting in part the SEC's motion for partial summary judgment ("April 25 Order"), that the GP interests are securities. Because the purported partnership agreement did not in fact convey any powers to investors at the time of investment, it cannot be disputed that the GPs were not independent entities, but rather were dependent upon, and under the control of defendants. *See* Dkt. 583, pp. 14-17; *see also Koch v. Hankins*, 928 F.2d 1471, 1476-77 (9th Cir. 1991) (applying *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981). For this reason alone, the GPs should remain in the receivership because the receiver is simply standing in the shoes of defendants and providing the managerial control over the GPs upon which investors have depended from the outset.[6]

Even if the Court had not yet held that the GP interests are securities, the evidence in the record establishes that the investors could not as a practical matter operate the GPs as independent entities without the managerial control of the defendants or the receiver. That evidence demonstrates that management of the GPs involves more than minimal administrative operations. First, management of the GPs involves selling real estate, which was how investors expected to obtain a return on their investments. Investors relied on Schooler to find a buyer, to negotiate a sales

[5] To the extent that the Court's August 16 Order was based on the amount of the receiver's fees, those fees are not unreasonable. The Court has approved all fees and costs paid to the receiver.

[6] The receiver has argued that because the Court has held that the GP units are securities, "no investment or real estate management company would agree to manage the GPs due to the potential liability to regulators and investors associated with them." Dkt. 584, p. 2. This further supports a finding that the GPs should remain in receivership.

price, and to determine when to sell the property. *See, e.g.*, Dkt. 12, ¶¶ 6, 8, 9; Dkt. NO. 19, ex. 4, pp. 199-201; Dkt. 414 ("I have faith that Schooler will eventually advise us to sell the properties at a good price.").

Second, given the number of investors in each GP, as many as 275, it is not possible for those investors to work together to make decisions within their GP. These investors had never met and were scattered throughout the country. Investors had no practical ability to make decisions or take action without relying on Schooler, Western, the receiver, or the partnership administrators. Western's promotional materials induced investors to believe that they could take a passive role in the GPs and rely on the managerial expertise of Schooler to produce profits. Indeed, defendants have conceded that they have no evidence that the investors could oversee their investments without the aid of Western, or that any investors had ever detached themselves from Western and administered a property themselves. The evidence in the record leads to the conclusion that investors relied on Schooler and Western to manage their investments and their GPs. *See* Dkt. 462, pp. 20-21; Dkt. 470, p. 25 (GPs "have always relied on Western to administer their operations"); Dkt. 511, p. 8 ("Schooler's frequent intervention on behalf of the GPs and the misinformed letters the Court has received from investors who have apparently relied on information from a website established by Schooler demonstrate that [contrary to defendants' position], the GPs actually do rely on Defendants to manage more of their affairs than mere administration of their partnerships."); Dkt. 512, p. 7 (Western "will remain financially responsible for making payments and contributions to the GPs as needed"); Dkt. 549, pp. 1-2 (letter sent by Schooler to investors "demonstrates, in the Court's view, an effort by Schooler to guide and influence the actions and perceptions of investors in these proceedings," and that such "efforts weigh against a finding of investor independence and in favor of a finding that investors have relied, and

continue to rely, on Schooler to make decisions regarding their investments.").[7]

Third, all decisions related to administration of a property had to be made by the unanimous agreement of multiple co-tenant GPs—a situation that defendants themselves conceded was "potentially unworkable." In one example, a group of co-tenant GPs sold their property in 2006 with seller financing. But the GPs were forced to take the property back via foreclosure, after the borrower defaulted, presumably through the managerial activities of defendants. *See* Dkt. 203, p. 1 n.1. In another example, land owned by a different group of co-tenant GPs was purchased by a public utility, but the utility later changed its mind, abandoned the land, and demanded that the GPs return the purchase price. *See* Dkt. 80, pp. 6-7. The receiver assumed control of Western during this process and was able to negotiate a settlement with the utility that was favorable to the GPs. Moreover, even if the GPs were to assume responsibility for making mortgage payments (owed by Western and not the GPs), the co-tenancy structure meant that each GP would be responsible for only a percentage of each mortgage payment, each property tax payment, and each insurance premium. The partnership administrators who were long-time Western employees coordinated the fractional payments of multiple GPs. Any decisions about these matters would require unanimous decision-making among multiple GPs. But there was no mechanism to perform this function other than Western's (or the receiver's) managerial role. And without an overall manager, co-owning GPs would not be able to decide how best to avoid foreclosure if Western failed to make mortgage payments. Without Schooler, Western, or the receiver to coordinate among multiple co-tenant GPs, complex activities of this sort would not be possible. Reconsidering the Court's August 16 Order and keeping the GPs in the receivership would be consistent to

[7] The receiver has also argued that the GPs should remain in the receivership because releasing them would harm investors due to a lack of corporate management, financial management, administrative management, and lack of property management. *See* Dkt. 584, pp. 2-4.

"promote orderly and efficient administration of the estate by the district court for the benefit of creditors." *SEC v. Hardy*, 803 F.2d 1034, 1038 (9th Cir. 1986).

Accordingly, in light of the prior facts in the record and the Court's more recent April 25 Order, the Court should reconsider its August 16 Order and keep the GPs in receivership.

III. THE COURT SHOULD PROVIDE INVESTORS WITH AN OPPORTUNITY TO FILE BRIEFS AND APPEAR AT THE HEARING

The SEC believes that investors should have the opportunity to file briefs and appear at the July 18, 2014 hearing on the reconsideration issue. Because reconsideration of the Court's August 16 Order does not concern the material deprivation of any property interest held by the GPs, the Court is not required to provide investors with an opportunity to be heard at the July 18 hearing. *See San Vicente*, 962 F.2d at 1407. Rather, so long as the GPs' properties remain in the receivership, a confirmation hearing would be required by statute before any sale of a GP property could be finalized and investors would have the opportunity to be heard at such a hearing. *See American Capital Investments, Inc.*, 98 F.3d at 1137 (9th Cir. 1996) (noting that 28 U.S.C. 2001 mandates a two-step process for approving the sale of receivership property, "the appointment of appraisers . . . followed by a sale confirmation hearing").

Nonetheless, given the level of investor interest in this action, the SEC believes that allowing investors to file briefs and appear could provide the Court with additional perspective important to its consideration of the matter. Although the Court has previously decided that defendants cannot present further arguments on behalf of investors (Dkt. 511, p. 8) and has cautioned defendants regarding their communications with investors (Dkt. 549, pp. 1-2), the SEC remains concerned about possible efforts by defendants to coordinate investor responses, particularly because the SEC has limited ability to see or even to know about such communications. Indeed, it is the SEC's understanding that Schooler held a meeting with investors at

his counsel's offices in early April to discuss, among other things, this action. The SEC therefore requests, to the extent that the Court permits investors to file briefs, that it set a briefing schedule that gives the SEC an opportunity to respond, if it chooses, to any investor submissions in advance of the July 18 hearing.

IV. CONCLUSION

For the foregoing reasons, the Court should reconsider its August 16 Order and maintain GPs in the receivership.

Dated: May 9, 2014

Respectfully submitted,

/s/ Sam S. Puathasnanon
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PROOF OF SERVICE

I am over the age of 18 years and not a party to this action. My business address is:

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On May 9, 2014, I caused to be served the document entitled **PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S BRIEF IN RESPONSE TO THE COURT'S APRIL 25, 2014 ORDER RECONSIDERING ITS AUGUST 16, 2013 ORDER** on all the parties to this action addressed as stated on the attached service list:

☐ **OFFICE MAIL:** By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

☐ **PERSONAL DEPOSIT IN MAIL:** By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

☐ **EXPRESS U.S. MAIL:** Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

☐ **HAND DELIVERY:** I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

☐ **UNITED PARCEL SERVICE:** By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

☒ **ELECTRONIC MAIL:** By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.

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☐ **FAX:** By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: May 9, 2014

/s/ Sam S. Puathasnanon
Sam S. Puathasnanon

SEC v. Louis V. Schooler, et al.
United States District Court – Southern District of California
Case No. 12 CV 2164 LAB JMA
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