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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 RESPONSIVE BRIEF REGARDING 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 its response to defendants' opening brief (Dkt. 586) concerning the Court's April 25, 2014 Order on the parties' cross-motions for partial summary judgment ("April 25 Order"). As discussed below, and in the SEC's opening brief (Dkt. 588), the arguments advanced by defendants lack merit and the Court should reconsider its August 16, 2013 order ("August 16 Order," Dkt 470), deny defendants' May 2013 motion for modification of the preliminary injunction (Dkt. 195), and maintain the GPs in the receivership.

First, defendants contend that the Court lacks jurisdiction to reconsider the August 16 Order because that Order is on appeal and the Court stayed the Order pending appeal. The SEC agrees that 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). But, as discussed in the SEC's opening brief (Dkt. 588, pp. 1-3), even if the parties' pending cross-appeals strip the Court of any authority over the August 16 Order, the Court may issue an indicative ruling pursuant to Rule 62.1 of the Federal Rules of Civil Procedure. This procedural device is designed for the situation presented here, when "relief is sought from an order that the court cannot reconsider because the order is the subject of a pending appeal." Fed. R. Civ. Pro. 62.1 Advisory Committee Notes. If the Court issues an indicative ruling, the Ninth Circuit may remand the cross-appeals for further proceedings while retaining jurisdiction or may dismiss the appeal as appropriate. *See* Fed. R. Civ. Pro. 62.1(c); Fed. R. App. P. 12.1(b).

Defendants have presented no authority or argument that would preclude the Court from issuing an indicative ruling. Their opening brief does not even address Rule 62.1, focusing instead on Rule 62(c).[1] *See* Fed. R. Civ. Pro. 62(c); Deft. Brief

[1] Defendants' response to the SEC's motion to stay, filed with the Ninth Circuit on May 14, 2014 (Ninth Cir. Dkt. 41-1) after defendants had notice of the SEC's Rule 62.1 argument, also fails to address Rule 62.1.

(Dkt. 586) at 2-5. But Rule 62(c) is irrelevant here because the Court is not addressing "terms that secure the opposing party's rights," such as the terms of a bond. *See* Fed. R. Civ. Pro. 62(c). Rather the Court seeks to reconsider its August 16 Order *sua sponte*. And under FRCP Rule 62.1 and FRAP Rule 12.1, the Court cannot enter a new order upon reconsideration unless the Ninth Circuit specifically remands following the issuance of an indicative ruling.[2]

Second, defendants argue that the April 25 Order "appears to conflate the issue of whether the GP interests are securities with the issue of whether maintaining a receivership over the GPs is justified under the laws and facts." Dkt. 586 at 5. Defendants, though, do not seem to recognize the significance of the Court's conclusion that the GP interests are investment contracts. In the April 25 Order, the Court acknowledged, citing to *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), that an "investment contract is 'a contract, transaction, or scheme whereby a person invests money in a common enterprise and is led to ***expect profits solely from the efforts of the promoter or third party***.'" Dkt. 583, p. 14 (emphasis added). The Court then focused its analysis on the third, or control, element of the *Howey* test for the existence of an investment contract: "the expectation of profits to be derived solely from the efforts of others." *Id.* Applying the *Williamson* test, the Court ultimately concluded that the SEC had satisfied the third *Howey* element, and therefore the GP interests were investment contracts, because the partnership agreements did not convey any powers to investors at the time of investment. *See* Dkt. 583, pp. 15-16. Because an investment contract involves promoters who "manage, control, and

[2] If the Ninth Circuit does remand, and the Court decided to keep the GPs in the receivership, the cross-appeals would likely be moot. Moreover, if the Court were to treat defendants' motion for modification (Dkt. 195) as a motion for reconsideration, then a denial of that motion would not be appealable, further reducing the possibility of multiple appeals before the Ninth Circuit. *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).

operate the enterprise," the Court's April 25 Order means that, as a matter of law, the GP investors are dependent on Western to manage, control, and operate the GPs. *See Howey*, 328 US at 300. Because of this dependence, the receiver, who has merely stepped into Western's shoes, is necessary to ensure the continued management, control, and operation of the enterprise.

Defendants' contention that "the Court's analysis of the offering period and the details regarding [the effectiveness of the Partnership Agreements] has absolutely no bearing on the question of whether the 86 GPs, now fully formed as separate legal entities, should or should not be subjected to receivership" (Dkt. 586, p. 9) is merely a straw man argument. The Court has not indicated that it wants to reconsider its August 16 Order because the investors lacked any partnership powers at the time of their investment. Rather, the Court seeks to reconsider whether the GPs should remain in the receivership "[g]iven the Court's conclusion that the GP units are securities." Dkt. 583, p. 20. This is an important distinction because, as discussed above, the conclusion that the GP units are securities in the form of investment contracts means that, as a matter of law, the investors are dependent on Western—and now the receiver—for management, control, and operation of the enterprise. Because the Court had neither considered "whether the Partnership Agreements were actually effective at the time of investing" (Dkt. 583, p. 16) nor found that, as a matter of law, the GP interests were investment contracts when it issued the August 16 Order, the Court has sufficient grounds to reconsider its August 16 Order now.

Third, defendants argue that a receiver over the GPs is not necessary because of the "minimal administrative activities" required to run the GPs, such as paying property taxes, insurance, and notes for the purchase of land from Western. *See* Dkt. 586, p. 6. But as they did in their summary judgment briefing (Dkt. 583, p. 16), defendants ignore the Co-Tenancy Agreements and their impact on the investors' ability to manage the GPs. Any decision concerning the property owned by the co-tenant GPs must be made by unanimous agreement of the GPs. As discussed in the

SEC's opening brief (Dkt. 588, pp. 8-9), without Schooler, Western, or the receiver to coordinate among the multiple co-tenant GPs, the GPs would be unable to take collective action. Reconsideration of the August 16 Order is particularly appropriate in light of the co-tenancy arrangement created by Schooler because the August 16 Order did not expressly consider how the unanimity requirement restricted the GPs' ability to manage themselves.[3]

As discussed more fully in the SEC's opening brief (Dkt. 588, pp. 7-8), investors also depend on Western and the receiver to make decisions and take action concerning each specific GP. The number of investors in each GP, coupled with the fact that the investors are largely strangers to each other and scattered throughout the country, leave the investors with no practical ability to manage the GPs without Western. This inability to manage is supported by the fact that defendants have presented no evidence that investors have or can oversee their investments without Western.[4]

In addition, the receivership has and will provide additional benefits to investors. One of the collateral benefits of the receivership is the litigation stay incorporated into the preliminary injunction. This stay protects the receivership estate, which currently includes Western and the GPs, from being named as a party in litigation, shielding these entities from the significant costs associated with mounting a defense. Removing the GPs from the receivership would potentially expose them to lawsuits, including any foreclosure actions that may arise if a mortgage default

[3] In its October 5, 2012 preliminary injunction order, which included the appointment of a receiver over the general partnerships, the Court found that the SEC had established a *prima facie* case that the GP interests were securities. The Court was "especially persuaded by the fractional nature of the interests." Dkt. 44, p. 22.

[4] Defendants' opening brief also argues that the receivership over Western is unnecessary (Dkt. 586, p. 9), which is also the subject of defendants' recently-filed motion for modification of the PI to remove Western from receivership (Dkt. 581). The SEC and the receiver have opposed that motion. *See* Dkt. 584, 587.

occurs. Another benefit to investors has been the receiver's efforts to appeal property tax assessments on several GP properties. Using the court-approved appraisals he obtained, the receiver has managed to reduce the assessed value of several properties, resulting in reduced property tax liability to certain GPs. *See* Dkt. 547, p. 5; Dkt. 584, p. 3. And the receiver will likely be needed to propose a plan of distribution, conserve assets for the distribution, and then make distributions to investors. Because the Court has already determined that the GP interests are securities, that Order established the SEC's *prima facie* case for a violation of Section 5 of the Securities Act of 1933 (SEC's Fourth Claim for Relief), *i.e.* that defendants offered and sold unregistered securities. Defendants have admitted that they "have not filed any registration statement with [the SEC] and that no registration statement has been in effect with respect to any of the GP investment offerings." Dkt. No. 255 (Answer), p. 12. And neither defendants' answer, nor any of their briefs filed in this action, have asserted any exemptions in defense to the SEC's Section 5 claim. Defendants only defense appears to be that "no registration statement is necessary because the GP investment offerings in fact, and at law, are not securities." *Id.* But the April 25 Order has rendered that defense moot. If defendants are found liable for Section 5 violations, the remedies available to the SEC include disgorgement of the offering proceeds. *See SEC v. Platforms Wireless Int'l Corp*, 617 F.3d 1072, 1096-97 (9th Cir. 2010). These offering proceeds would then be distributed to investors based on a plan proposed by the receiver and approved by the Court.

Fourth, defendants argue that imposition and continuation of a receivership harms the GPs because it removes control of land by the GPs. *See* Dkt. 586, p. 7. Other than stating that the investors do not retain full control of the GPs, though, defendants do not explain the effect of the receivership on any rights that investors may have. And the investors in F-86 Partners actually do not have control of their land because their offering did not close and the resulting transfer of ownership of property from Western to the GPs did not occur. It cannot be disputed that those

investors are currently dependent on the receiver to manage, control, and operate their investment. Also, as noted by the receiver, the terms of several of the older GPs have expired, calling into question their ability to control their respective properties, further supporting the need for a receiver over the GPs. Indeed, the receiver was and is necessary to seek authority from the Court and to administer a vote of the affected GPs to determine whether to extend the term of the agreements or sell the land.

Fifth, defendants suggest, wrongly, that the receivership has imposed "unexpected" costs on the investors. *See* Dkt. 586, p. 7. Defendants again fail to provide any support for their conclusory assertion. In fact, since the receiver's appointment in September 2012, investors have not been asked to pay the costs of the receivership. Defendants point to legal fees and consultant/expert fees as specific costs of the receivership. But these fees have been borne by Western, not the investors. And the Court has approved every fee application filed by the receiver and its professionals. To the extent that defendants' argument refers implicitly to the receiver's operational billing, the amounts due under those bills relate to operations of the GPs and are not unexpected, unnecessary or unjustified. The bills seek money from investors to pay for property tax, property insurance, preparation of tax returns, retention of the partnership administrators, and investors' share of the amount owed to Western to finance their purchase of GP units. Moreover, to the extent that defendants' argument refers implicitly to the $51,001 deducted by the receiver from GP accounts to date, those funds were withdrawn, with Court approval, in exchange for reducing Western's equity in GPs. *See* Dkt. 206, p. 5. The reduction of Western's equity interests, in turn, actually increased each investor's pro-rata ownership of the respective GP, meaning each investor stands to receive a greater portion of GP assets. Investors were not responsible for paying any portion of the $51,001 paid to the receiver from GP accounts.

Finally, with respect to due process, the SEC has previously stated that investors should have the opportunity to file briefs and appear at the July 18, 2014

hearing on the reconsideration issue. Dkt 588, pp. 9-10. However, the SEC disputes defendants' assertion that the Constitution requires investors to receive notice and opportunity to be heard prior to the imposition of a receivership. All the Constitution requires is that investors receive procedural due process prior to a 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).

For the foregoing reasons and those stated in the SEC's opening brief (Dkt. 588) and its opposition to defendants' motion to modify the preliminary injunction (Dkt. 587), the Court should reconsider its August 16 Order, deny defendants' May 2013 motion for modification of the preliminary injunction, and maintain the GPs in the receivership.

Dated: May 23, 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 23, 2014, I caused to be served the document entitled **PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S RESPONSIVE BRIEF REGARDING 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.

☒ **E-FILING:** By causing the document to be electronically filed via the Court's CM/ECF system, which effects electronic service on counsel who are registered with the CM/ECF system.

☐ **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 23, 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
(LA-4059)

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