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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 SIXTH INTERIM APPLICATIONS FOR APPROVAL AND PAYMENT OF FEES AND COSTS (RECEIVER AND COUNSEL)

Date: July 25, 2014
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

Defendants LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING CORPORATION (collectively "Defendants") respond as follows to the Sixth 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").[1]

I.

INTRODUCTION

The Receiver, on behalf of himself and Receiver's Counsel, has now filed six 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"), with the sixth application covering the period of October 1, 2013 through December 31, 2013.

The Receiver and Receiver's Counsel claim to have incurred a total of $125,803.81 in fees and costs for work performed for those three months, with $66,020.85 in fees and $333.93 in costs for the Receiver, and $59,170.95 in fees and $278.08 in costs for Receiver's Counsel. *See* Dkt. No. 569. These fees are calculated after a 10% fee discount for the Receiver. Dkt. No. 566, 2:15-17.

Defendants object to the Sixth 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"). This inaction by the Receiver also occurred during the time period of the Fourth and Fifth Interim Applications, as Defendants have

[1] Defendants do not oppose the Second Interim Fee Application for Duffy Kruspodin & Co., LLP, which has historically served as accountant for Western and the GPs (Dkt. No. 568), since the services performed by Duffy Kruspodin in 2013 would have been performed by that firm in the absence of the Receiver.

previously and repeatedly brought to the Court's attention. *See* Dkt. No. 407, 17:7-21 (nonpayment of May and June 2013 installments); Dkt. No. 505, 4:4-6:23 (nonpayment of May, June, August, and September 2013 installments); Dkt. No. 520, 5:1-6:1 and Dkt. No. 520-1 (nonpayment of October and November 2013 installments and noteholders' Notices of Default).

Therefore, ***the Receiver must be required to certify to the Court that all Underlying Notes are current before the Court approves any portion of the Sixth Fee Applications, because the Receiver did not comply with this Court's directive of August 16, 2013 to make the payments on the Underlying Notes during the period of October-December 2013.*** 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 have been used by the Receiver to pay his fees upon approval of the Third and Fourth Fee Applications, since it was not used to pay the Underlying Notes.[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.

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[2] As of October 25, 2013, the date of Defendants' Opposition to the Fourth Fee Applications, the Receiver refused to pay the scheduled payments for August 2013 and September 2013 on the Underlying Notes, despite sufficient cash on hand. Defendants' attorneys requested an explanation from the Receiver's counsel in writing, but received no response whatsoever. As a result of the Receiver's unresponsiveness, Mr. Schooler's [Western's] staff contacted seven of the beneficiaries on the Underlying Notes, all of whom reported (from mid-October to late November) that their loans were in default with payments or late fees still outstanding. Three of the beneficiaries had mailed Notices of Default (NODs) but had not yet recorded NODs against the GPs' titles yet. *See* Dkt. No. 520-1. Needless to say, the Receiver's behavior during the time of the Sixth Fee Applications was an extraordinary abuse of discretion and merits nothing but his removal from control of Western.

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 – including Western - 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 through the Receiver's parasitism on Western.

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 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's paying himself ahead of the Underlying Notes has prioritized repayment of lowest-priority unsecured, non-recourse debt ahead of higher-priority secured debt. The Receiver cannot be allowed to be paid for actions that are a direct breach of his duty of care to the receivership entities.

Therefore, Defendants request that the Sixth Interim Applications be ***denied***. In the alternative, to the extent the Court decides to approve any portion of the Sixth Interim Applications, the Receiver must first be required to bring the Underlying Notes current, keep them current, and pay all accrued late fees, which accrued solely through his inaction and neglect.

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 was 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). This trend continued through the period of the Fifth and Sixth Fee Applications. *See* Dkt. Nos. 505, 520, 537. 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 as the Fee Applications are granted.

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] To make up the alleged shortfall during the period of the Sixth Fee Application, the Receiver moved *ex parte* for an order to collect money from the GP investors. Dkt. No. 519. Defendants objected to the Receiver's *ex parte* application and submitted evidence that the Receiver was failing to pay the Underlying Notes and that several of the noteholders had declared the Underlying Notes in default and threatened to invoke the Underlying Notes' acceleration clauses. Dkt. No. 520.

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 Western and the GPs while Western and the GPs remain under receivership. *Sovereign Bank v. Schwab*, 414 F.3d 450, 454 (3d Cir. 2005) ("A receiver owes a fiduciary duty to the owners of the property under his care");

[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.

see also City of Chula Vista v. Gutierrez, 207 Cal.App.4th 681, 143 Cal.Rptr.3d 689 (2012). 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, as all the documents setting forth the underlying relationships require. 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 Western requires it, but he has repeatedly breached that duty – and violated this Court's orders - by causing a default on a secured debt when there is available cash and no higher priority payment obligation required.

On July 18, 2013, during the period covered by the Fifth Fee Application, 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. 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 has claimed 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."

As of this date, after repeated requests by Defendants both in filings with this Court and in correspondence with the Receiver's counsel, the Receiver has not provided a list of payments, while the beneficiaries of the Underlying Notes continued to notify Schooler through October and November 2013 to report that the Receiver had not made the payments. *See* Dkt. No. 520-1.

The Receiver's failure to pay has caused great harm to Western, the GPs, and the investors. 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 Sixth Fee Applications should be denied.

B. 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 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 with regard to the GPs, since the receivership over the GPs is now to be dissolved. Dkt. No. 470.

The problems faced were not truly complex at the beginning of the receivership and have not grown more complex since. There are the same number of entities, bank accounts, properties, and investors relevant to the receivership; 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 – the same situation as the day the receivership began.

The continued receivership over Western remains unnecessary. There has been no proof of fraud, money laundering, or offshoring of funds. The Receiver has completed his forensic accounting of Western (*see* Dkt. Nos. 182, 504), thus clarifying Western's financial affairs (*see* Dkt. No. 59). Therefore, there is no reason for the Receiver to be in place at all.

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). This is of particular significance when the Receiver and Receiver's Counsel and forensic computer consultants have billed ***approximately $796,000 over the course of the Receivership as of December 31, 2013***.[4]

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).

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[4] This sum was derived by adding the fees and costs and rounding to the nearest dollar for each category. It does not include the fees for the accounting firm (Duffy Kruspodin) and Nevada law firm (Cotton Driggs) because the costs of their services would have been incurred by the GPs and Western in the normal course of operations, without the Receiver being present.

III.

CONCLUSION

The Sixth Application for fees and costs requested by the Receiver and Receiver's Counsel should be denied. The requested fees and costs continue to be unreasonable under the circumstances. There is no showing as to how the work performed between October 1, 2013 and December 31, 2013 has benefitted Western (or the GPs, for that matter). The actions taken by the Receiver during that period, such as the continued 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.

For all of the reasons set forth above, Defendants request that the Sixth Interim Applications be ***denied***. In the alternative, to the extent the Court decides to approve any portion of the Sixth Interim Applications, the Receiver must first be required to bring the Underlying Notes current, keep them current, and pay the accrued late-payment fees.

DATE: July 11, 2014

Respectfully submitted,

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CERTIFICATION

I hereby certify that on the 11th day of July 2014, 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:

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