Nos. 16-55850, 16-56362

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

U.S. SECURITIES & EXCHANGE COMMISSION,
Plaintiff – Appellee,

v.

LOUIS V. SCHOOLER; FIRST FINANCIAL PLANNING CORPORATION,
DBA Western Financial Planning Corporation,
Defendants – Appellees,

JOSEPH M. ARDIZZONE, DAVID R. SCHWARZ, LOIS SCHWARZ,
DENNIS FRISMAN, ERIC GILBERT, AND RICK MOORE,
Intervenors – Appellants,

THOMAS C. HEBRANK,
Receiver – Appellee.

On appeal from the United States District Court
for the southern District of California, Case No. 3:12-cv-02164-GPC-JMA

RESPONSE BY JOSEPH M. ARDIZZONE, DAVID R. SCHWARZ, LOIS SCHWARZ, DENNIS FRISMAN, ERIC GILBERT, AND RICK MOORE TO THE MOTION OF THE SECURITIES AND EXCHANGE COMMISSION TO CONSOLIDATE APPEALS NOS. 16-55850 AND 16-56362

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I. Introduction

Joseph M. Ardizzone, David R. Schwarz, Lois Schwarz, Dennis Frisman, Eric Gilbert, and Rick Moore ("Appellants") question the assumption of the Securities and Exchange Commission ("SEC") that the consolidation of the two appeals (Nos. 16-55850 and 16-56362) would not delay the resolution of their appeal. D.E. 4 at 7.[1] Only this Court may know whether a consolidation of the Graham and Ardizzone appeals will delay its decision of the Ardizzone appeal.

Since the SEC went ahead with this motion, Appellants state their position here on consolidation. If the consolidation would *not* delay the Ardizzone appeal, the Appellants would join the SEC's motion to consolidate the Ardizzone appeal (No. 16-56362) with the Graham appeal (No. 16-55850). On the same premise—that the consolidation does not delay the Ardizzone appeal—Appellants would propose that the appeals by the two investor groups (Nos. 16-55850 and 16-56362) be consolidated with the appeal taken by Defendant Schooler (No. 16-55167). All three appeals share a single factual issue which profoundly affects each appeal. And that issue may be stated: Did Western control the GPs at any time, and, if so, when?

On the other hand, if it appears that the consolidation would delay the appeal or if the Court is unable to make that decision, Appellants must oppose the motion

[1] "D." refers to the corresponding docket entry in *SEC v. Schooler*, No. 12-cv-02164 (S.D. Cal.); "D.E." refers to the corresponding docket entry with this Court.

to consolidate appeals Nos. 16-55850 and 16-56362. Indeed, Appellants may seek an order to expedite their appeal depending on how the Court rules on the motions pending before it. It was because of this uncertainty that we informed the SEC that their motion was premature.

For Appellants, delay equates to prejudice. The issues on appeal ultimately boil down to one question: Who will make the decision what will be done with the investments of 3,370 investors in 87 general partnerships ("GPs")? Will it be those investors, who own 94% of the GPs and control 100% of voting power under the GP agreements? Or will it be the SEC staff attorneys and the SEC-sponsored receiver, Thomas C. Hebrank "Hebrank," who make that decision for investors? As this appeal is slowed, and Hebrank carries out his plan, he makes that decision for investors and their appeal becomes moot.

Only an order from this Court can stop Hebrank. And it could be either of two orders: one staying the district court's May 25, 2016, order (D. 1304) or one vacating it. It would be imprudent for any litigant to presume to know what decision this Court will make on any pending motion or when it will make that decision. Consequently, we foresee scenarios which would cause delay and thus prejudice, if the appeals are consolidated. We address those concerns below.

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II. The SEC's "Background Facts" Distort the Truth

The SEC presents as "Background Facts" an overview of the case which substitutes a myth for fact. In this context, the SEC passes off as "Background Facts" its claim that Hebrank gave "notice" to all 3,370 investors of his liquidation plan and only ten percent of the investors retained counsel to oppose him. The SEC implies on appeal, as Hebrank argued before the district court (see, for example, D. 1263 at 2, ll. 18-23), that the other 3,000 investors—those unrepresented by counsel—embrace Hebrank's plan. This is pure myth.

Neither the SEC nor Hebrank has conducted a survey to obtain investors' views whether they favor or oppose Hebrank's plan. And while the SEC and Hebrank persist in arguing or implying the silent majority of investors support their position, both the SEC and Hebrank have doggedly opposed every proposal by the Graham Appellants to have investors speak for themselves, vote on a plan, or participate in the decision what should be done with their investments, the 87 GPs in which investors are general partners. Both opposed the Graham Appellants' proposal that the district court follow the procedures in a Chapter 11 proceeding with a disclosure statement and investors voting on a reorganization plan. D. 1293-1 at 8.[2] The district court rejected the Graham Appellants' proposal. D. 1304. The

[2] Local Rule 66-8 for the District Court for the Central District of California provides in part: "***Permanent and Temporary Receivers-Administration of Estate.*** Except as otherwise ordered by the Court, a receiver shall administer the estate as

SEC opposed (D. 1278) the Graham Appellants' proposal that the district court use the class action procedure to afford investors due process before confiscating their property. D. 1277 at 6. The district court rejected the class action procedure. D. 1304 at 12.

In this light, the only barometer of investors' sentiment is the result of a survey conducted by members of the *ad hoc* committee for the Graham Appellants. It yielded the following results:

Question	Total	Yes	% Yes	No	% No
1. Investors want GPs removed from Receivership	1045	977	93.49%	68	6.51%
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3. Investors want an accounting	1047	1019	97.33%	28	2.67%

D. 1293-3 at 4. The *ad hoc* committee lacks accurate email addresses for approximately 1,000 investors, because it used a list of investor email addresses obtained from Western and that list had erroneous or no email addresses for 1,000 to 1,200 investors. D. 1368-5, ¶¶ 5-6. Given the fact these investments were made between 1981 and 2012, many investors are now in their late 60s, 70s, 80s, and even 90s and may lack computer skills. The Pew Research Center found last year that 42% of Americans above the age of 65 do not even use the internet.[3]

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nearly as possible in accordance with the practice in the administration of estates in bankruptcy. "

[3] See http://www.pewinternet.org/2015/06/26/americans-internet-access-2000-2015/, last visited Oct. 11, 2016.

III. Delays in This Appeal Will Cause It to Become Moot

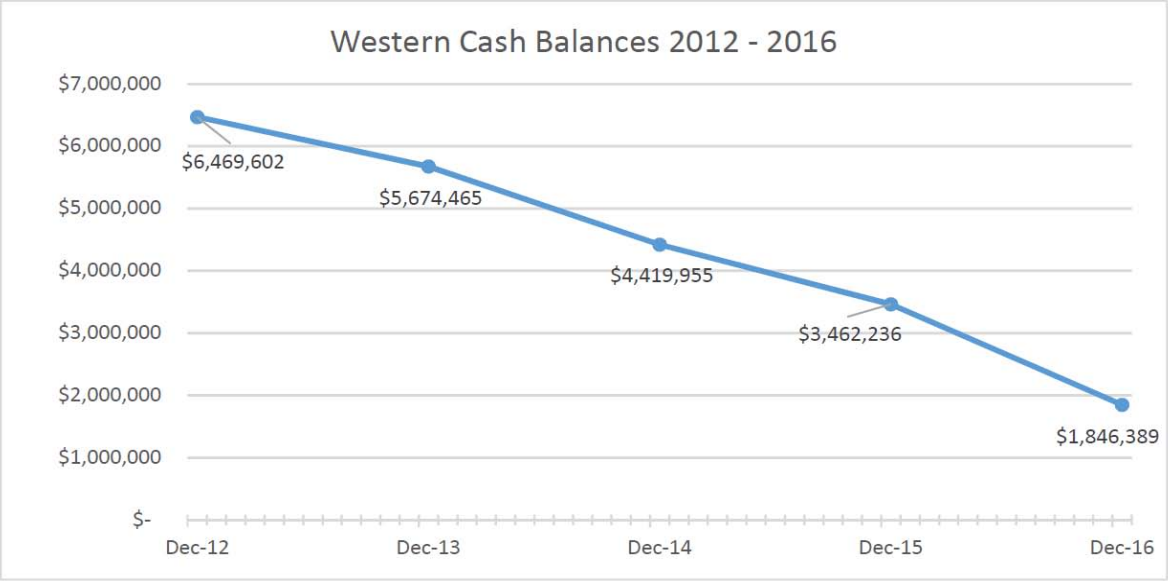
While the briefing is stayed and thus the progress of the appeal, Hebrank may proceed with his own plan what should be done with the investments of the 3,370 partners in the 87 GPs. He has pooled the funds from the 87 GPs' bank accounts. D. 1319 at 4. He has obtained orders confirming the sales of two of the properties. Ds. 1360 and 1361. He can do the same with the remaining 34 properties as soon as he gets an offer and he has numerous brokers now scouting for them. Any delay in this appeal increases the risk it will become moot.

IV. Any Delay of the Appeal Means Hebrank Will Continue to Exhaust Investors' Assets

After being ordered twice to disclose the amount and source of the funds he has collected over the past four years, Hebrank filed revised interim reports on September 20, 2016, disclosing the fact he had collected $14.2 million from investors and their GPs during the period of his receivership. Ds. 1376 at 17 and 20; 1377 at 21; and 1378 at 27. No one contends investors will recover anything from the SEC's case against the defendants. Western's assets will be consumed by the receivership expenses. Hebrank was pessimistic whether the SEC would recover funds from Schooler (D. 1181-1 at 11) before Schooler died. Appeal No. 16-55167, D.E. 47 at 1.

But the facts are indisputable on one point: investors will lose big through this receivership every day it continues. Hebrank collected a fresh $14.2 million

from investors and their GPs during his receivership (Ds. 1376 at 17 and 20; 1377 at 21; and 1378 at 27) and also took control of the $6.6 million in the GP bank accounts when he was appointed (D. 1181-1 at 6), a total of $20.8 million. Hebrank expects the $6.6 million in cash in the bank accounts to be reduced to $1.8 million by the end of this year. *Id*. Here is Hebrank's chart tracking the falling cash balance in the GP bank accounts from the outset of the receivership.



It is almost a straight line, which means the loss in the first two years would likely continue. And this does not include the $14.2 million in cash Hebrank collected from investors and the GPs during his receivership. The SEC obtained an injunction staying investors from taking any actions to protect their investments, e.g., putting them in Chapter 11 or seeking a judgment they had no liability on the notes they signed. D. 10. In short, the receivership has been a financial disaster for investors.

That means Hebrank will have spent $19 million ($20.8 million minus $1.8 million) by the end of 2016. That is an expenditure of $373,000 per month or $12,300 per day. To the extent the funds are exhausted, they will not be replenished. Since investors began investing in 1981, many are now advanced in age and well into retirement. Much of their funds are held in IRAs or otherwise set aside for retirement. Once those assets are consumed by the receivership, they are gone for good. And for those well into retirement, there is little chance to replenish those assets.

V. The Continuation of the Receivership Puts Investors at Risk, Because It Has No Due Process Protection and Investors' Voice Has Been Muted

The SEC's case against Schooler has been reduced to a final judgment. There are no proceedings before the district court to enforce the judgment. Defendant Schooler is now deceased. His appeal is being continued at the SEC's request. Appeal No. 16-55167, D.E. 47. The only issue now before the district court is what to do with the assets in the receivership. Hebrank holds the assets in a stewardship for investors. He has no financial interest in those assets except to pay the receivership fees. The SEC has no interest in those assets. Yet, both the SEC and Hebrank have doggedly fought to keep investors from participating in the district court proceedings focused exclusively on the disposition of the 87 GPs owned by investors.

We would expect the SEC and Hebrank to invite investor participation in the decision what to do with their investments. The bankruptcy court routinely administers reorganization plans which have embedded procedures compliant with due process requirements which allow for creditor and investor participation and representation in reorganization plans. See: *Bank of New York Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

The SEC and Hebrank will likely protest that every step they have taken was done to protect investors, just as Hebrank did when he obtained an order excusing him from serving most of his filings on investors. D. 170. But it is challenging to accept this statement when the receivership has done nothing for investors and will cost them $18.9 million by the end of this year.

In a nutshell, the SEC and Hebrank convinced the district court to carry out their liquidation or reorganization plan, but with none of the protections embedded in those proceedings by the Bankruptcy Act or Bankruptcy Regulations. As an example, the district court crafted its own criteria for a liquidation plan, but with no disclosure statement, procedure for creditors and investors to vote for or against it, procedures for interested parties to submit alternative plans, or even to simply oppose it (D. 1224 at 2), which are all routine protections with a plan under

Chapter 11. See: 11 U.S.C.S. § 1125(b); *Everett v. Perez (In re Perez)*, 30 F.3d 1209 (9th Cir. 1994).

Consequently, the SEC and Hebrank took this case down the wrong path, according to decisions from this Court and the Second Circuit. In *SEC v. Lincoln Thrift Asso*., 577 F.2d 600 (9th Cir. 1978), the Ninth Circuit observed:

> In recognition that liquidation of a corporation under a securities receivership may more properly be the subject of a bankruptcy proceeding, this Court has reversed a district court order for liquidation of a corporation in a securities receivership.

See also: *SEC v. TLC Invs. & Trade Co*., 147 F. Supp. 2d 1031, 1036 (C.D. Cal. 2001) ("It is only in rare cases that it is appropriate for a receiver, rather than the bankruptcy court and particularly before judgment has been entered, to liquidate, rather than manage, the assets of a receivership."); *SEC v. American Bd. of Trade, Inc*., 830 F.2d 431, 437-438 (2d Cir. N.Y. 1987)("[T]he functions undertaken by the district court in this case demonstrate the wisdom of not using a receivership as a substitute for bankruptcy.") The Second Circuit in *American Trade* directed the SEC's appellate counsel, "as an officer of the court … to bring our views … to the attention of the district court before the court embarks on a liquidation through an equity receivership.")[4]

[4] See also Megan E. Smith, Comment, *SEC Receivers and the Presumption of Innocence: The problem with Parallel Proceedings in Securities Cases and the Ever Increasing Powers of the Receivers*, 11 HOUS. BUS. & TAX L.J. 1, 203-31 (2011).

VI. Conclusion

For the forgoing reasons, Appellants oppose the SEC's motion to consolidate the two matters if it causes any delay in the decision of this appeal.

DATED: October 11, 2016

Aguirre Law, APC

By: /s/ Gary J. Aguirre
GARY J. AGUIRRE
Attorney for the Ardizzone Appellants

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing document with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 11, 2016. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

October 11, 2016

/s/ Gary J. Aguirre

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Nos. 16-55850, 16-56362

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JOINDER BY THE GRAHAM INVESTORS TO THE ARDIZZONE INVESTORS' RESPONSE TO THE MOTION OF THE SECURITIES AND EXCHANGE COMMISSION TO CONSOLIDATE APPEALS NOS. 16-55850 AND 16-56362

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Attorney for Appellants
Susan Graham, et al.

Susan Graham and the 191 Intervenors-Appellants listed in Attachment 1 filed herewith join in the Ardizzone Investors' Response to the Motion of the Securities and Exchange Commission to Consolidate Appeals Nos. 16-55850 and 16-56362 (Dkt. Entry 6 in Appeal No. 16-56362). A copy of said Response is attached hereto as Exhibit 1.

Dated: October 11, 2016

Respectfully submitted,

By: /s/ Gary J. Aguirre

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gary@aguirrelawapc.com
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Exhibit 1

Nos. 16-55850, 16-56362

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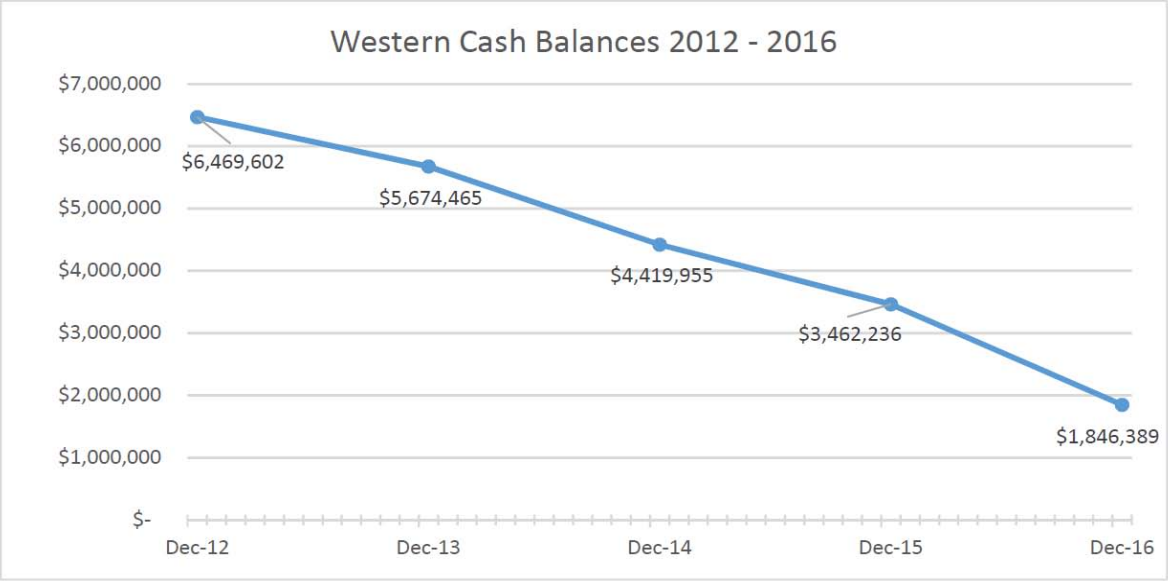

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That means Hebrank will have spent $19 million ($20.8 million minus $1.8 million) by the end of 2016. That is an expenditure of $373,000 per month or $12,300 per day. To the extent the funds are exhausted, they will not be replenished. Since investors began investing in 1981, many are now advanced in age and well into retirement. Much of their funds are held in IRAs or otherwise set aside for retirement. Once those assets are consumed by the receivership, they are gone for good. And for those well into retirement, there is little chance to replenish those assets.

V. The Continuation of the Receivership Puts Investors at Risk, Because It Has No Due Process Protection and Investors' Voice Has Been Muted

The SEC's case against Schooler has been reduced to a final judgment. There are no proceedings before the district court to enforce the judgment. Defendant Schooler is now deceased. His appeal is being continued at the SEC's request. Appeal No. 16-55167, D.E. 47. The only issue now before the district court is what to do with the assets in the receivership. Hebrank holds the assets in a stewardship for investors. He has no financial interest in those assets except to pay the receivership fees. The SEC has no interest in those assets. Yet, both the SEC and Hebrank have doggedly fought to keep investors from participating in the district court proceedings focused exclusively on the disposition of the 87 GPs owned by investors.

We would expect the SEC and Hebrank to invite investor participation in the decision what to do with their investments. The bankruptcy court routinely administers reorganization plans which have embedded procedures compliant with due process requirements which allow for creditor and investor participation and representation in reorganization plans. See: *Bank of New York Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

The SEC and Hebrank will likely protest that every step they have taken was done to protect investors, just as Hebrank did when he obtained an order excusing him from serving most of his filings on investors. D. 170. But it is challenging to accept this statement when the receivership has done nothing for investors and will cost them $18.9 million by the end of this year.

In a nutshell, the SEC and Hebrank convinced the district court to carry out their liquidation or reorganization plan, but with none of the protections embedded in those proceedings by the Bankruptcy Act or Bankruptcy Regulations. As an example, the district court crafted its own criteria for a liquidation plan, but with no disclosure statement, procedure for creditors and investors to vote for or against it, procedures for interested parties to submit alternative plans, or even to simply oppose it (D. 1224 at 2), which are all routine protections with a plan under

Chapter 11. See: 11 U.S.C.S. § 1125(b); *Everett v. Perez (In re Perez)*, 30 F.3d 1209 (9th Cir. 1994).

Consequently, the SEC and Hebrank took this case down the wrong path, according to decisions from this Court and the Second Circuit. In *SEC v. Lincoln Thrift Asso*., 577 F.2d 600 (9th Cir. 1978), the Ninth Circuit observed:

> In recognition that liquidation of a corporation under a securities receivership may more properly be the subject of a bankruptcy proceeding, this Court has reversed a district court order for liquidation of a corporation in a securities receivership.

See also: *SEC v. TLC Invs. & Trade Co*., 147 F. Supp. 2d 1031, 1036 (C.D. Cal. 2001) ("It is only in rare cases that it is appropriate for a receiver, rather than the bankruptcy court and particularly before judgment has been entered, to liquidate, rather than manage, the assets of a receivership."); *SEC v. American Bd. of Trade, Inc*., 830 F.2d 431, 437-438 (2d Cir. N.Y. 1987)("[T]he functions undertaken by the district court in this case demonstrate the wisdom of not using a receivership as a substitute for bankruptcy.") The Second Circuit in *American Trade* directed the SEC's appellate counsel, "as an officer of the court … to bring our views … to the attention of the district court before the court embarks on a liquidation through an equity receivership.")[4]

[4] See also Megan E. Smith, Comment, *SEC Receivers and the Presumption of Innocence: The problem with Parallel Proceedings in Securities Cases and the Ever Increasing Powers of the Receivers*, 11 HOUS. BUS. & TAX L.J. 1, 203-31 (2011).

VI. Conclusion

For the forgoing reasons, Appellants oppose the SEC's motion to consolidate the two matters if it causes any delay in the decision of this appeal.

DATED: October 11, 2016

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing document with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 11, 2016. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

October 11, 2016

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