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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.: 3:12-CV-02164-GPC-JMA

REPLY BY THE ARDIZZONE INVESTORS TO PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S OPPOSITION TO MOTIONS
(1) FOR A STAY OF ORDERS PENDING APPEAL,
(2) TO ALTER OR AMEND A JUDGMENT, AND
(3) FOR RECONSIDERATION

Date: November 10, 2016
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

I. Introduction

Most of the SEC's opposition brief argues two issues: (1) the *process* afforded the Ardizzone Investors was adequate and (2) the Ardizzone Investors raise no new issues. In this way, the SEC sidesteps the primary and distinguishing contention the Ardizzone Investors raise by their motion for a stay and their motion to intervene. While the Ardizzone Investors have incorporated in their motion to intervene every contention raised by the Graham Investors, they also contend that they and all other investors were deprived of due process of law in one additional way the Graham Investors did not. The receiver, Thomas C. Hebrank ("Hebrank") gave them inadequate or no notice of his February 4, 2016, motion (Dkt. No. 1181) for an order approving his liquidation plan. Hebrank's attorney sent a copy of his plan to the Graham Investors' counsel in early February 2016, but gave inadequate or no notice of that plan to 3,000 other investors, including the Ardizzone Investors.

The SEC also persists with its flawed analysis of the notice issue. No one denies several hundred frustrated investors learned of the receivership and sent letters to the Court and to Hebrank. But that, at most, proves several hundred investors learned of the receivership. as discussed below, It does not begin to prove that investors were given the notice required by *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306 (U.S. 1950).

II. Who Are Litigants in This Action?

The Ardizzone Investors' claims they have been deprived due process may be reduced to a simple statement: they have not had a voice in the proceedings that divested them of their property and redistributed it to others. But that is not the only way the SEC and Allen Matkins have diminished the voice of investors in this case. When investors questioned whether Hebrank was serving their best interests in 2014, Allen Matkins labeled them the "Schooler Groups" of investors and referred to them 19 times in this way in a single brief.[1] In this way, Allen Matkins told the Court to distrust the investors'

[1] Dkt. No. 852 at 5, 6, 7, 18, 23, 24, 25 and 27; and Dkt. No. 852-1 at 20.

message, because they were mindlessly parroting Defendant Schooler.

After the entry of a final judgment in this case, Defendant Schooler all but vanished from the proceedings before this Court. When this Court distinguished between the two groups of investors in its April 5, 2016, order (Dkt. No. 1224) as the "Aguirre Investors" and the "Dillon Investors," these terms caught on with both the SEC and Hebrank. Now, Hebrank has taken it a step further, referring to a new group of investors as the "New Aguirre Investors." This appellation diminishes these litigants' role to pawns in this litigation, which is exactly the role then SEC and Hebrank urge for them. The Ardizzone Investors request they be referred to in their name, not in the name of their attorney.

III. The Lack of Adequate Notice to Investors

A. "Notice" to Investors Failed to Comply With *Mullane* and Its Progeny

The SEC ignores the key Supreme Court case which redefined the manner in which notice must be given in cases where the courts exercise *in rem* jurisdiction. More concretely, the SEC ignores the Ardizzone Investors' argument in their opening brief that Hebrank's email and website "notices" failed to comply with the directives in *Mullane* requiring the notice to be "reasonably calculated" to reach investors. Dkt. No. 1368-1 at 11-20. The facts from which the notice issues arise in *Mullane* are remarkably similar to those in this case. In *Mullane*, the property was intangible as it is here: rights as beneficiaries under a trust in *Mullane*, rights of partners to the assets of general partnerships ("GPs"), which are held in trust under California law, Cal. Corp. Code § 16404(b)(1), in this case. The beneficiaries of the trusts in *Mullane* were bound by an accounting, which the trustee never sent them even though he had their names and addresses. The investors here are bound by a liquidation plan and accountings of the GP assets that were never sent to them, even though Hebrank had their names and addresses.

Mullane held the statutory notice by publication was unconstitutional as a violation of the Due Process Clause. In language equally applicable here, *Mullane* held: "Where the names and post-office addresses of those affected by a proceeding are at hand, the

reasons disappear for resort to means less likely than the mails to apprise them of its pendency." 339 U.S. at 318. *Mullane* explained why owners of intangible property, unlike owners of tangible assets, must receive notice. *Mullane* noted that an owner of tangible property, chattels or realty, normally "learn of any direct attack upon his possessory or proprietary rights." *Id*., at 316. On the other hand, the beneficiaries of the trusts in *Mullane*, as investors here, do not learn of the seizure of their property in the same way since it is intangible.

Mullane also explained why the need for notice is heightened when the trustee, as a fiduciary, provides an accounting to its beneficiary: "But it is their caretaker who in the accounting becomes their adversary (emphasis added)." *Id*. In the same way, Hebrank, in his accounting of *investor* funds, the seizure of their assets, and the redistribution of their assets, "becomes their adversary." *Mullane* explained why the trustee there and Hebrank here cannot be released from giving real notice that reaches the beneficiaries: "Their trustee is released from giving notice of jeopardy, and *no one else is expected to do so* (emphasis added)." *Id*.

Again, *Mullane*'s holding could have been written for this case: "Where the names and post-office addresses of those affected by a proceeding are at hand, the reasons disappear for resort to means less likely than the mails to apprise them of its pendency." *Id.,* at 318. According to Hebrank, he had the mailing addresses for more than 99 percent of investors.[2] Hence, *Mullane* bars Hebrank from using a form of notice which, by his own admission, failed to reach a majority of investors (posting to his website) *and one third investors* (by email). The Ardizzone Investors have submitted evidence indicating that more than half of investors are unaware of Hebrank's plan. Dkt. No. 1393-2 ¶ 8.

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[2] Hebrank states in his email of October 25, 2012,, that his October 10, 2012 letter was sent to all 3,370 investors except 24 whose letters were returned undelivered. Dkt. No. 1368-6, ¶ 7, Ex. 1.

1 And these are real people who are being divested of their property with no
2 knowledge of Hebrank's plan, the hearing, or the Court's order. *Five declarations by*
3 *investors stating these facts are submitted with this reply brief.*
4 Significantly, Hebrank has never filed a proof of service of any notice in this case:
5 one stating the names of the investors he has served and how he did it. Further, the Court
6 should discard the unsworn, hearsay, conclusory statements of Hebrank's counsel except
7 that Hebrank's emails failed to reach at least one third of investors. Dkt. No. 1393 at 2-3.
8 *Mullane* also rejected the excuse of saving money to justify a less effective means
9 of giving notice, i.e., less effective service is not justified because "a prudent man of
10 business" might be "counting his pennies." 339 U.S. at 320. In this case, Hebrank cannot
11 excuse his failure to send notice by mail to save money, since he knew his notice was not
12 "reasonably calculated to reach those who could easily be informed by other means
13 [mail] at hand." *Id.*, at 319.
14 Both the SEC and Hebrank pass over another requirement for notice: it must warn
15 the recipient of some action that affects his property rights. *Id.,* at 317. Relying on
16 *Mullane*, the district court in *Friedman v. United States EPA,* 2005 U.S. Dist. LEXIS
17 49598 *15 (E.D. Cal. 2005) held, "The regulation at issue must give fair warning of the
18 conduct it prohibits or requires."
19 In addition to giving a warning, the notice must also spell out how the recipient
20 may be heard. In *Memphis Light, Gas & Water Div. v. Craft*, 436 U.S. 1 (U.S. 1978), the
21 utility gave sufficient notice of the warning, but failed to provide a procedure to raise
22 objections. Again, the Supreme Court held: "Petitioners' notification procedure, while
23 adequate to apprise the Crafts of the threat of termination of service, was not 'reasonably
24 calculated' to inform them of the availability of 'an opportunity to present their objections'
25 to their bills." 436 U.S. at 14. *Mullane* explained the point of the warning: "This right to
26 be heard has little reality or worth unless one is informed that the matter is pending and
27 can choose for himself whether to appear or default, acquiesce or contest." 339 U.S. at
28 314. See also *Greene v. Lindsey*, 456 U.S. 444, 452 (1982). In this context, *In Re San*

1 *Vicente Medical Partners, Ltd.*, 962 F.2d 1402, 1407 (9th Cir. 1992) held: "The
2 Constitution requires that property owners receive procedural due process in the form of
3 notice and opportunity for a hearing."

4 Hebrank has utterly failed to provide investors with notice that his proposed plan
5 would divest them of their property rights in the GPs. To begin with, the plan to sell all
6 the GP realty, pool the proceeds, and divvy up the pooled funds did not come into
7 existence until February 4, 2016. Dkt. No. 1181. Accordingly, any notice of his plan
8 would have to be sent after that date.

9 Hebrank claims he sent two letters, October 2012 and March 2013 (Dkt. No. 1383
10 at 4) to all investors, but none gives a clue that Hebrank would later propose a plan
11 divesting investors of their property. Consequently, both letters failed to comply with
12 *Mullane*. Further, the two letters fail to comply with *Memphis*, because neither provided a
13 procedure to object to the divesture of investors' property. The two letters gave even less
14 warning than the beneficiaries received in *Mullane*, which the Supreme Court held was
15 inadequate:

16
17 The trustee has on its books the names and addresses of the income
18 beneficiaries represented by appellant, and we find no tenable ground for
19 dispensing with a serious effort to inform them personally of the accounting,
20 at least by ordinary mail to the record addresses. *Certainly sending them a copy of the statute months and perhaps years in advance does not answer this purpose* (citations omitted)

21 339 U.S. at 318.

22 Hebrank's website postings and his emails[3] failed to comply with *Mullane's*
23 mandate that notice be given by mail when the notice sender has the names and addresses
24 of those entitled to notice. The emails and website postings before February 4, 2016, also
25 fail to warn investors that Hebrank planned to divest investors of their rights under the GP
26
27
28

[3] The Ardizzone investors have addressed the specific failures of Hebrank's emails and letters to investors to comply with *Mullane* in the Declaration of Gary J. Aguirre filed herewith, see ¶¶ 3-13, and Exs. 1-13.

1 agreements, including their property rights in the GP assets upon dissolution. See Aguirre
2 Decl. ¶¶ 3-10, Exs. 1-11.
3 The SEC argues Hebrank sent email "notices" of the hearings held in October 14,
4 2014, and January 2015 but neither warned investors their assets would be divested. The
5 SEC ignores the conflicts between these notices and the mandates of *Mullane*. Hebrank
6 knew his emails never reached at least one third of investors. Yet, Hebrank had their
7 mailing addresses and, in violation of the explicit directives of *Mullane*, failed to send
8 them his notice by mail. Further, these emails could not and did not *warn* investors that
9 Hebrank's plan would divest them of their property rights under the GP agreements, since
10 Hebrank did not conceive that plan for another year. The only issue before the Court from
11 October 2014 until the Court's March 4, 2014, order was whether the GPs would be
12 permitted to exit the receivership before the case was concluded. On March 4, 2015, the
13 Court held the GPs could not exit the receivership until "the conclusion of this case." Dkt.
14 No. 1003 at 18-19. On March 9, 2015, Hebrank informed those investors *for whom he*
15 *had email addresses* that "the Court ruled that the GPs shall be kept in the receivership
16 through the conclusion of the case." Aguirre Decl. ¶ 10, Ex. 11.
17 Indeed, Hebrank told investors throughout this same period that investors would be
18 able to vote on what should be done with their GPs. Hebrank's November 24, 2014, email
19 (Aguirre Decl. ¶8, Ex. 9) informed investors he had filed a report with the Court. Dkt.
20 No. 852. As in his earlier reports, Hebrank told investors the assets of a specific GP
21 would only be distributed to partners in that GP ("Other than what investors recover from
22 their GP,…"), unless the GP was worthless, in which case investors would receive
23 nothing from their GPs. Dkt. No. 852 at 16, 21-22. By telling investors they would
24 receive the net assets in cash from their GPs, Hebrank collected another $14.2 million
25 directly or indirectly from investors over 45 months. Dkt. Nos. 1376, 1377 and 1378.
26 Until February 4, 2016, Hebrank consistently took the position that investors
27 would share only in the funds and assets of the GPs they owned. That abruptly changed
28 when Hebrank filed his liquidation motion on February 4, 2016. For the first time,

1 Hebrank told investors he would sell all the GPs' assets without their consent. For the
2 first time, Hebrank told investors all of their assets would be pooled and distributed *pro*
3 *rata* to all investors. This reversed the message Hebrank had repeatedly given investors
4 throughout the receivership, including his November 24, 2014, email discussed above.
5 Consequently, adequate notice of Hebrank's February 4, 2016, motion to all
6 investors was imperative. Hebrank's posting of his motion to his website failed to comply
7 with *Mullane*, because it was in principle similar to publication; most investors never saw
8 it. Dkt. No. 852 at 2. Hebrank's May 6, 2016, email violated *Mullane*'s mandates at
9 multiple levels. Aguirre Decl., ¶ 11, Ex. 12. First, since Hebrank had more than 99% of
10 investors' names and addresses, under *Mullane*, Hebrank's reasons for giving notice
11 through "means less likely to reach" investors (his website or emails) "disappeared." 339
12 U.S. at 318. Second, the notice "must afford a reasonable time for those interested to
13 make their appearance." *Id*. The "notice" was sent three weeks after the deadline for a
14 *party* to file opposition. For nonparty investors, they would have to intervene and that
15 was impossible to do within the deadlines imposed by the Local Rules, since the May 6,
16 2016, "notice" came only two weeks in advance of the hearing. Further, the May 6, 2016,
17 email failed to comply with the requirement of *Memphis* that it inform investors of the
18 availability of "an opportunity to present their objections." 436 U.S. at 14. The May 6,
19 2016, email and link to the motion provided no procedure for investors to object. Aguirre
20 Decl., ¶ 11, Ex. 12. As discussed in our reply to Hebrank's opposition (Dkt. No. 1393),
21 the May 6, 2016, email failed to comply with Local Rule ("L.R.") 66.1 and the March 7,
22 2013, order (Dkt. No. 170 at 3), which required the notice be sent by mail.
23 Finally, the May 6, 2016, email was sent 42 months after the complaint was filed
24 and thus came far too late in the proceeding. See *Layton v. Beyer*, 953 F.2d 839, 851 (3d
25 Cir. 1992) and L.R. 66.1.a.2 and 66.1.d. By that time, the Court had already decided the
26 GP interests were securities (Dkt. No. 583) and that defendants had committed fraud in
27 relation to the Stead property. Dkt. No.1081. Both orders were relied on by the Court in
28 its May 25, 2016, order. Dkt. No. 1304 at 2, 6, 22, 28, 30.

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B. None of the "Notices" Complied with Local Rule 66.1

2 In its opposition, the SEC argues, "The only notice requirement regarding investors 3 under Local Rule 66.1.a.2 is the requirement that the ***Receiver*** give notice to the 'creditors 4 listed' in a list that the defendants are obligated under the rule to provide." Dkt. No. 1389 5 at 15. This is flat wrong and the SEC knows it is wrong. Local Rule 66.1.a.2 requires (1) 6 a hearing and (2) notice of the hearing to investors. In particular, the rule provides: "A 7 permanent receiver may be appointed after notice and hearing upon an order to show 8 cause." And on the issue of notice to investors, it states: "Not less than seven (7) days 9 before the hearing, the temporary receiver (or, if none, the plaintiff) must mail to the 10 creditors listed the notice of the hearing, and file the proof of mailing." The SEC told the 11 Court in its first brief filed in this case exactly what the Ardizzone Investors are telling 12 the Court now. Citing *San Vicente*, the SEC informed the Court there would have to be 13 "notice and an opportunity to be heard before any of [the GPs'] assets are placed under 14 the control of a permanent receiver." Dkt. No. 3-1 at 31. Further, in the proposed order 15 submitted by the SEC, which was signed by Judge Burns, the SEC set a hearing on 16 September 17, 2012, to show cause why Hebrank's appointment should not be made 17 permanent. The order further required that notice be sent by "certified mail" to all 18 "receivership entities and their general partners." Dkt. No. 10 at 20. Accordingly, the 19 SEC's statement is simply wrong.

20 In our opening brief, the Ardizzone Investors explained how the pre-notice hearing 21 and the hearing were cancelled. The SEC, Hebrank, and defendants stipulated away 22 investors' rights to the hearing under L.R. 66.1. Dkt. Nos. 207 at 2-3 and 1368-1 at 5. As 23 for investors' right to a pre-hearing notice, that right evaporated when Judge Burns asked 24 the SEC what type of notice investors were entitled to and the SEC's counsel responded:

25 26 27 28
> But if there is—if the court is going to make the receiver a permanent receiver, *then notice needs to be given that the general partnerships have been placed in receivership*. That is really the crux of our concern. *And how that notice—what that looks like is not as significant as long as they know* (emphasis added).

Reporter's Transcript of September 17, 2012, hearing, at 52. The SEC had suggested in its brief that the requirement of a prehearing notice stems from the holding of the Ninth Circuit in *San Vicente* at 1408. Dkt. No. 3-1 at 31. The SEC's citation of *San Vicente* for the requirements of a pre-hearing notice to investors strongly suggests the requirements of L.R. 66.1 were based on *San Vicente*.

The application of L.R. 66.1 to Hebrank's liquidation motion is addressed in the Ardizzone Investors' opening brief (Dkt. No. 1368-1 at 17-25) and reply to Hebrank's opposition. Dkt. No. 1383 at 6-9.

C. None of Hebrank's Communications Meet the *Mullane* Requirements

Aside from the failure of the notice to be reasonably calculated to reach investors, there is another flaw that runs throughout the SEC's and Hebrank's claim that investors due process rights were served. The notice must warn the recipients how their property rights will be affected and give them an opportunity to object. Only the email forwarding the Court's July 22, 2014, order remotely combines a warning any procedure to object. Of course, it was not sent to at least one third of investors and likely many more.[4] As discussed above, the order severely limited the conditions under which investors could address the Court, the extent to which they could speak, and the subject on which they could speak. They were limited to the issue whether the GPs could exit the receivership before the case was concluded. The proceedings did not deal with Hebrank's permanent appointment, the sale of GP property without the partners' approval, or the distribution of GP assets to non-partners.

Nor has the SEC or Hebrank produced any communication (1) telling investors of their rights to a noticed hearing before Hebrank's appointment became permanent or (2) warning investors Hebrank's plan would call for the sale of all GP property without the partners' approval and the distribution of GP assets to non-partners.[5] Only Hebrank's May

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[4] Supplemental Declaration of Dennis P. Gilman, ¶ 8.

[5] The lack of compliance with *Mullane* by the letters and emails Hebrank sent, to the extent he had email addresses, are addressed in Aguirre Decl., ¶¶ 3-13.

6, 2016, email, spoke to this issue, but, as discussed above, it failed to comply with *Mullane* at multiple levels.

D. The District Court's Failure to Order an Accounting Violated Investors' Due Process Rights

Mullane also held that a judicial proceeding that bound beneficiaries to the trustees' accounting of their funds violated the beneficiaries' due process rights when notice was given by publication, but should have been served by mail since the trustee had the beneficiaries' names and addresses. *Mullane* reasoned:

> In two ways this proceeding does or may deprive beneficiaries of property. It may cut off their rights to have the trustee answer for negligent or illegal impairments of their interests. Also, their interests are presumably subject to diminution in the proceeding by allowance of fees and expenses to one who, in their names but without their knowledge, may conduct a fruitless or uncompensatory contest. Certainly the proceeding is one in which they may be deprived of property rights and hence notice and hearing must measure up to the standards of due process.

339 U.S. at 313. The same is true here. Hebrank has spent $19 million of investors' funds pursuant to orders based on motions which were never served on investors, even though Hebrank at all times had their names and addresses. This included $14.2 million Hebrank collected from investors upon his representation investors had the duty to pay this cumulative sum as partners in the GPs. Dkt. Nos. 1376, 1377 and 1378. Just as the beneficiaries' due process rights were violated in *Mullane* when the trustee failed to send them his accounting of their funds, investors' rights in this case were violated when Hebrank failed to serve them with the accountings of their assets.

DATED: October 25, 2016

Respectfully submitted,

By: /s/ Gary J. Aguirre

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