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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

GRAHAM INVESTORS' REPLY TO OPPOSITIONS TO INTERVENTION TO OPPOSE, OBJECT TO AND REQUEST CLARIFICATION OF (1) SECOND REVISED 14TH INTERIM REPORT, (2) REVISED 15TH INTERIM REPORT AND (3) REVISED 16TH INTERIM REPORT

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

I. Introduction

The receiver, Thomas C. Hebrank ("Hebrank"), has again failed to comply with this Court's order directing him to comply with the SFAR Instructions requiring him to restate the source of the funds reported at line 8 of each revised SFAR. Dkt. No. 1369 at 16. The SEC raises procedural objections, while Hebrank complains compliance would be too burdensome. The Graham Investors[1] address both arguments below.

Hebrank and Allen Matkins have their reasons for failing to comply. Compliance would force Hebrank to disclose how much new money he collected from investors. He collected *some* new money from investors when he knew, but investors did not, that they would never get it back. And he waited awhile—the exact period is unknown—before he told investors this bitter truth. If an investment adviser engaged in the same conduct, the SEC would charge him or her with fraud and seek to ban them from the industry.

II. The Graham Investors Complied with Each Element of Fed. R. Civ. P. 24(a)

The SEC argues: "First, the Graham Investors do not meet the four-part test set forth in *Donnelly v. Glickman*, 159 F.3d 405, 409 (9th Cir. 1998), to determine whether intervention as of right should be granted…" Dkt. No. 1395 at 2. In the SEC's words:

> Although the investors falsely argue that the Court has already ruled that they satisfy the first three prongs for intervention, what the Court actually held is that these "elements are plausibly met ***as to the Receiver's orderly sale motion***," not for all purposes, and certainly not for purposes of substituting themselves as the monitor of the Court-appointed Receiver.

Id. The Graham Investors address below each prong under Rule 24(a) in this section.

Timeliness

First, neither the SEC nor Hebrank argues that the motion to intervene was untimely. It was filed on October 4, 2016, (Dkt. No. 1381) 14 days after Hebrank filed his revised reports on September 20, 2016. Dkt. Nos. 1376, 1377 and 1378.

[1] The names of the Graham Investors are listed in Attachment 1 filed herewith.

The Graham Investors' Protectable Interest May Be Impaired

The SEC argues that this Court's May 18, 2016, order (Dkt. No. 1296) finding the Graham Investors' had satisfied the second and third prongs of Rule 24(a) was limited to the orderly sale motion. In context, the order reads:

> Here, the second and third elements are plausibly met as to the Receiver's orderly sale motion. As investors in Defendants' scheme, the Investors have an interest relating to the transaction that is the subject of the action. The disposition of the GPs, because it involves the winding up of the receivership and the sale of the GP properties, may, as a practical matter, impair the Investors' ability to protect their interests in the GP properties.

Dkt. 1296 at 4. The accuracy and integrity of Hebrank's accounting of the receivership funds are obviously intertwined with the winding up of the receivership, since his accounting defines the amount of funds available for distribution. Likewise, inaccuracies in the accounting would impair investors' rights to their share of the receivership funds.

Indeed, the Graham Investors' right to question Hebrank's accounting of the assets entrusted to him is a right protected by the Due Process Clause. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306 (U.S. 1950). The issues in *Mullane* and here are very similar. In *Mullane*, the fiduciary was a bank which held assets of numerous beneficiaries in a trust. In this case, Hebrank is the fiduciary of 3,370 investors who, as partners, have property rights in the assets of 87 GPs, since each GP holds its assets in trust for its partners. Cal. Corp. Code § 16404(b).

Mullane held that a trustee's notice by publication of its accounting to the trust beneficiaries under a state statute violated the Due Process Clause. Before the Supreme Court could reach that issue, however, it would have to decide a threshold issue: whether a court order approving the trustee's accounting could deprive the beneficiaries of due process of law. The Supreme Court found that it did in two ways:

> 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.

Just as the trustee bank sought an order approving its accounting in *Mullane*, Hebrank has filed three motions seeking orders approving his interim accounting reports, including four SFARs, from the beginning of his receivership through June 30, 2016. Hebrank's SFARs cover the following periods: (1) the 12 quarters from the last quarter of 2012 through the third quarter of 2015 (Dkt. No. 1376, Ex. C, at 15-17), (2) the last quarter of 2015 (*Id*., at 18-20) (3) the first quarter of 2016 (Dkt. No. 1377, Ex. C, at 19-21), and (4) the second quarter of 2016 (Dkt. No. 1378 Ex. C, at 25-27).

Like the trustee in *Mullane*, Hebrank is a fiduciary of other people's money. Like the trustee in *Mullane*, Hebrank has potential liability for the misuse of the funds in his receivership. Like the trial court in *Mullane*, this Court's order may "cut off their rights to have [Hebrank] answer for negligent or legal impairments of their interests." 339 U.S. at 313. Like the beneficiaries in *Mullane*, the Graham Investors' due process rights may be impaired by orders of this Court approving Hebrank's accounting of receivership funds. Consequently, the Graham Investors' rights to object to Hebrank's accounting of the GP assets are protected under the Due Process Clause.

Neither the SEC nor Hebrank Adequately Represent the Graham Investors

The interests of both Hebrank and the SEC are in absolute conflict with investors' interests when it comes to the accuracy of Hebrank's accounting of his receipts and disbursements of investors' funds. As *Mullane* found: "It is their caretaker who in the accounting becomes their adversary." 339 U.S. at 316. Likewise, Hebrank, as the caretaker of investors' assets, "becomes their adversary" when his accounting of those assets is in issue. In this case, Hebrank failed to comply 13 times with the SEC SFAR

mandates and the SEC never uttered a word of protest. Significantly, the Court's May 18, 2016, order, had no limitation on its finding: "The Court finds that the Investors' interest is not adequately represented by the existing parties." Dkt. No. 1296 at 8.

III. Hebrank Has Not Complied with the SFAR Requirements

The SFAR "Report Instructions"[2] direct Hebrank to state the following information in response to Line Item 8: "Line 8-Miscellaneous-Other: Amounts received from, an *identified payor* (emphasis added)." Hebrank fails to comply with the Report Instructions for SFAR in two ways. First, he fails to comply with his own self-serving interpretation of those instructions. Second, he fails to comply with the actual language.

Hebrank argues that the language in the Report Instructions on Line 8 directing SEC-sponsored receivers to state the "Amounts received from, an identified payor" does not mean what it says. Rather, Hebrank argues this language should be interpreted to mean that he must only "provide a summary report of the financial activity for the Receivership entities." Dkt. No. 1394 at 2. Assuming *arguendo* the validity of this argument, Hebrank would still be required to identify each *class* or *category* of payor or his SFARs would be meaningless. His argument that he "counted twice " receipts, though untrue, all but concedes inaccuracies in his four revised SFARs that render them useless.

Hebrank concedes his SFARs bundle together two classes of payors—investors and the GPs—and two classes of payees—the GPs and Western. *Id.*, at 3. Hebrank's response to Line 8 in each of his four revised SFARs provides one number for the sums collected from both payors—investors and the GPs—by both payees—the GPs and Western. Hebrank states in his four revised SFARs (Dkt. Nos. 1376, 1377 and 1378) the GPs *and* Western collected a total of $14.2 million from investors *and* the GPs. The table below summarizes the information Hebrank provided at Line 8 of each SFAR:

Dkt. No.	Period	Payors	Recipients	Amounts
1376	9/2012 to 9/2015	Investors & GPs	GPs & Western	$12,661,867
1376	10/2015 to 12/2015	Investors & GPs	GPs & Western	$696,066

[2] See https://www.sec.gov/oiea/Article/billinginstructions.pdf at 2.

Dkt. No.	Period	Payors	Recipients	Amounts
1377	1/2016 to 3/2016	Investors & GPs	GPs & Western	$766,481
1378	4/2016 to 6/2016	Investors & GPs	GPs & Western	$101,201
	Total			**$14,225,615**

But once again, Hebrank renders this data useless with his caveat that the "payments are counted twice for the purpose of SFARs." Dkt. No. 1394, at 3, l. 13. For the sake of clarity, these "counted twice" receipts must be distinguished from the "double counting" of receipts Hebrank asserted last May (Dkt. No. 1292 at 12, l. 16) in defending a different set of inaccuracies in his interim reports. Curiously, neither Hebrank's revised interim reports nor his revised SFARs stated that he "counted twice" the receipts. It appears Hebrank only claims he "counted twice" or "double counted" when his accounting is called into question.

Hebrank explains how his "counted twice" receipts were posted to his SFARs:

> In this sense, the payments are counted twice for purposes of the SFAR (once when they are received by the GPs and once when they are received by Western), but the actual amounts received by each GP and by Western are reflected on Exhibits A and B to the interim reports.

Dkt. No. 1394 at 3, ll. 13-16. To grasp what Hebrank is saying, it is necessary to track theoretical payments moving through Hebrank's books. Hebrank counts the money the first time when investors pay their GPs, e.g., $1 million to their GPs. Hebrank claims to count it a second time when the GPs pay the same $1 million to Western. Since the $1 million is counted twice, it shows up as $2 million on Hebrank's SFARs for the quarter. Since Hebrank claims the $14.2 million was "twice counted," it follows that investors paid their GPs $7.1 million and the GPs paid the same $7.1 million to Western, resulting in the $14.2 million reported at Line 8 on Hebrank's four revised SFARs. If this were true, Hebrank received $7.1 million of new money from investors.

But suppose Hebrank's statement is untrue. i.e., he did not "twice count" the same investor payment. Suppose instead that the cash went to the GPs and they did not transfer it to Western. Instead, they paid their bills directly, e.g., taxes, professional fees,

insurance and so on. Likewise, investors could repay loans directly to Western without the funds passing through the GPs. This would mean no receipts were "counted twice." In this case, the entire $14.2 million would be new money from investors.

Hebrank's claim he "counted twice " all receipts is patently false. Though sparse, the accounting records Hebrank released establish the GPs made substantial payments directly to third parties which did *not* pass through Western. For example, in 2014, Production Partners paid $1,500 for administrator payroll, $30,286 in property taxes and bond payments, $1,158 for an appraisal, and $8,300 for operational loan repayments. Those amounts and other payments add up to $42,742, from which *only* $8,300 were paid to Western. Aguirre Declaration filed herewith, ¶¶ 4-6, Ex. 1. In other words, the GP paid out $34,442 to payees other than Western. Hence, these receipts were not "counted twice." The same pattern exists with all GPs. Hence, Hebrank's claim he "counted twice " the receipts is untrue. While it is true that some funds were "counted twice," Hebrank's statement he did so with all receipts is untrue.

Hebrank's failure to specify even the *category* of the payor or payee renders his SFARs close to useless. At best, Hebrank is stating: "I received somewhere between $7.1 million and $14.2 million in new money from investors thus far in this receivership." Hebrank offers a second untrue statement to corroborate his "counted twice" myth:

> With respect to what Line 8 of the SFAR includes, it includes all payments made by investors to GPs (the GP-by-GP totals of which are reported on Exhibit A to the interim reports) and all payments made by investors and GPs to Western (the totals of which are reported on Exhibit B to the interim reports).

Dkt. No. 1394 at 3, ll. 6-9. This response misses the point. SFAR requires an SEC-sponsored receiver to identify the payor in Line 8 of the SFAR. Instead, Hebrank invites this Court to extract this information from Exhibit A (GPs' receipts and disbursements) and Exhibit B (Western's revenues) from 14 interim reports, add them up, and then compare them with the SFARs for the same period. Why not simply state the true facts?

The Graham Investors have undertaken the process Hebrank proposes and the numbers do not add up. If Hebrank's statement were true, the receipts stated in Exhibit A plus the receipts from the GPs and investors specified on Exhibit B would equal the amounts specified at Line 8 of each SFAR for the same period.

But they don't. The total amounts Hebrank reported on Exhibit A for the first three years (12 quarters) of the receivership add up to $5,166,077.71 and the receipts from GPs and investors on Exhibit B for the same period add up to $2,960,189.93, a total of $8,126,267.64. Aguirre Decl., ¶ 9. The SFAR for the same period states Hebrank collected $12,661,867 from the GPs and investors. *Id*., ¶ 10, and Dkt. No. 1376 at 17. This difference is $4,535,599.36. To be clear, Hebrank's SFAR states he collected $4.5 million more from investors and the GPs than his interim reports for the same periods state. Likewise, the SFARs for the last quarter of 2015 exceed the amounts collected from the GPs and investors as reported on Exhibits A and B by $100,316.92. Aguirre Decl., ¶ 11. For the first quarter of 2016, the difference was $44, 551.25. *Id*., ¶ 12. For the quarter ending in June 2016, the SFARs showed $107,563.58 less collected from the GPs and investors than Exhibits A and B to the same report. *Id*., ¶ 13. In short, Hebrank's corroboration for his "counted twice" myth is a second myth.

Thus far, the Graham Investors have been addressing the big picture: how much new money did Hebrank take from all investors? By bundling the amounts received from investors and the GPs into one figure, he sidesteps the requirement of Item 8 on SFAR. But the SFAR Report Instructions on Line 8 do not give Hebrank the option of providing summaries. Rather, they direct Hebrank to state: "Amounts received from, an identified payor."[3] This language is not ambiguous. It directs Hebrank to state the amounts received from "an identified payor," one identified business entity or identified person.

Finally, Hebrank argues, "[T]he Aguirre Investors fail to show that publicly reporting the date and amount each investor and GP payment will benefit investors or

[3] *Supra*, n. 2.

the receivership estate." Dkt. No. 1394 at 3, ll. 4-5. Neither our motion nor the SFAR Reporting Instructions sought that level of detail. Rather, they direct Hebrank to specify: the "Amounts received from, an *identified payor*." This means that Hebrank state the total amount of funds he received from each person and each GP for each quarter. The Graham Investors also agreed this information could be filed under seal with the Court, if Hebrank also provided an unredacted copy to them. Dkt. No. 1381-2 at 5. Hebrank's claim this information would not "benefit investors" opens a new issue.

IV. Hebrank Failed to Disclose to Investors They Would Never Get Their Money Back when He Pressed Them to Pay Fees and Repay Notes.

Hebrank questions why the disclosure of the exact amounts he collected from investors would benefit them. The answer is simple: both the Court and investors should know how much Hebrank's receivership has harmed investors and how much it harmed each investor. For that reason, the Court should not approve any accounting by Hebrank that is not fully compliant with SFAR's Reporting Instructions. As in *Mullane*, this Court's orders may insulate Hebrank and Allen Matkins from liability for conduct that cost investors many millions of dollars. 2 Clark on Receivers (3d ed. 1992), § 321.1 at 586. At this point, only Hebrank, Allen Matkins, and likely the SEC know how many millions.

Hebrank and Allen Matkins clearly seek an order that would immunize them from liability. Hebrank's SFARs cover 15 quarters of his receivership: from the last quarter of 2012 through the second quarter of 2016, 45 months. Curiously, this Court's May 25, 2016, order only directed Hebrank "to withdraw and resubmit Receiver's Fourteenth Interim Report, ECF No.1189, and submit all future fee reports, consistent with SFAR." Dkt. No. 1304 at 24. Hebrank had no obligation to submit a SFAR covering the *first three years* of his receivership. He did so voluntarily. He now asks the Court to approve his SFARs accounting for the 12 quarters during which he failed to file a single SFAR. In this way, Hebrank and his counsel seek to immunize themselves

from any potential liability arising from their handling of the receivership. Clark, § 321.1 at 586.

And both Hebrank and Allen Matkins have reason for concern. Investors will never get back the millions of dollars they paid Hebrank over the first 45 months of his receivership. Hebrank's liquidation motion tells why:

> Specifically, if the assets of the receivership estate are being pooled for *pro rata* distribution to all investors, *continuing to collect investor note payments no longer makes sense*. All investors will all have an interest in the assets of the receivership estate consistent with the amounts they have invested. Collecting further funds from certain investors, of which they are projected to only recover 13.40%, would be inequitable (emphasis added).

Dkt. No. 1181-1 at 25. In plain talk: it "no longer makes sense," because anyone who pays Hebrank a penny will not be getting it back. Just as true, though Hebrank did not say it, investors who paid him millions of dollars over the prior 42 months would not be getting them back either.

Curiously, even after Hebrank filed his liquidation motion, investors continued to pay him money they would never get back. During the first quarter of 2016, investors paid Hebrank $553,795, including $99,239 in February, and $185,803 in March. Dkt. No. 1377 at 15. They paid another $85,519 in the second quarter of 2016. Dkt. No. 1378 at 19. Quite obviously, these investors did not know the money they were paying Hebrank was going in a black hole. The warning quoted above was tucked away at page 25 of Hebrank's liquidation motion, a motion posted to his website, which he knew most investors never visited. Dkt. No. 852 at 2. While clueless investors, most of them elderly, continued sending Hebrank money they would never get back, Hebrank waited through February, March, April, and into May before he sent them 56 pages of legalese with the his vague warning tucked away on page 25. *See* May 6, 2016, email, Dkt. No. 1348-3 at 13-14.

So, how long did Hebrank know that he was taking money from elderly investors who would never get it back? Did Hebrank receive a divine message on the morning of

February 4, 2016: "Go with pooling." Or had Hebrank decided earlier to accept the SEC's standard distribution plan (pooling), but continued to collect funds from investors knowing they would never get them back? The SEC began talking up pooling in January 2015 when it argued: "Indeed, there are numerous examples of SEC enforcement actions in which funds, including disgorged assets, have been pooled and distributed to investors in the absence of a Fair Fund." Dkt. No. 880 at 14. The SEC also implied that the Court's May 2015 order (Dkt. No. 1074) may have prompted Hebrank's plan to pool the assets. Referring to that order, the SEC noted: "it is no surprise at all that the receiver's recommended distribution plan calls for a *pro rata* distribution of assets equally to all investors." Dkt. No. 1266 at 14. If Hebrank was planning to pool as early as the SEC began proposed it, he collected another $1.675 million from investors knowing investors would never get them back. Aguirre Decl. ¶¶ 9-12.

For investors, this money is gone for good. These losses are layered on top of any they may have suffered at the hands of the defendants. Further, investors had a defense to paying Hebrank anything under the GP agreements, because each of those agreements was an unregistered security. Had the SEC not stayed all suits by investors, investors could have brought their own claims that the GP agreements were unregistered securities under Sections 12(a)(1) of the Securities Act of 1933. *Pinter v. Dahl*, 486 U.S. 622, 629 (1988). At a minimum, investors had a defense to paying Hebrank any additional sums under those agreements.

For these reasons, the Graham Investors respectfully submit that Hebrank should fully comply with the Reporting Instructions for the four SFARs he filed, before the Court approves his interim reports.

Dated: October 31, 2016

Respectfully submitted,

By: /s/ Gary J. Aguirre
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