No. 16-55850

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.

SUSAN GRAHAM, ET AL.,

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

RECEIVER'S RESPONSE TO APPELLANTS' SUPPLEMENTAL BRIEF FOR REVIEW OF THE COURT IN SUPPORT OF URGENT MOTION UNDER CIRCUIT RULE 27-3(B) APPELLANTS' MOTION FOR STAY PENDING APPEAL (D.E. 12)

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Appellee Thomas C. Hebrank ("Receiver"), Court-appointed receiver for First Financial Planning Corporation d/b/a Western Financial Planning Corporation ("Western"), its subsidiaries and the General Partnerships listed on Schedule 1 to the Preliminary Injunction Order entered by the District Court on March 13, 2013 ("GPs" and collectively, "Receivership Entities"), hereby responds to the Graham Investors' Supplemental Brief for Review of the Court in Support of Urgent Motion Under Circuit Rule 27-3(B) Appellants' Motion for Stay Pending Appeal (D.E. 12) ("Supplemental Brief").

I. INTRODUCTION

The Graham Investors' Supplemental Brief is based in part on a misunderstanding of jurisdictional principles. They argue the District Court erred in placing the GPs in the receivership because it failed to consider whether it had ***subject matter jurisdiction*** over the GPs. Subject matter jurisdiction, however, applies to the claims at issue in a case – the subject matter of the case – not the parties or property involved in a case. There is no question the District Court has federal question subject matter jurisdiction over the SEC's claims that Defendants violated federal securities laws, including the appointment of the Receiver as a remedy to address such claims.

In contrast, whether the parties or property involved in a case are properly before the District Court or included in a receivership depends on ***personal***

jurisdiction, including the doctrines of *in rem* jurisdiction and *quasi in rem* jurisdiction. Although personal jurisdiction (or *quasi in rem* jurisdiction) was never challenged by the GPs, the District Court properly determined Defendants had managerial control over the GPs, the GPs had minimum contacts with California (which is undisputed), and the GPs had been given notice and an opportunity to be heard. D. 10, 44, 583, 629, 1003, 1304.[1] Therefore, the District Court properly exercised *quasi in rem* jurisdiction over the GPs in including them in the receivership. Moreover, the GPs waived any objection to personal jurisdiction (including *quasi in rem* jurisdiction) by failing to challenge it at any time during the case. Finally, the Graham Investors, who have interests in the GPs, but do not have authority to speak for the GPs or even have a voting majority in any GP, lack standing to contest personal jurisdiction over the GPs. Accordingly, the Graham Investors cannot show a likelihood of success on the merits of their appeal.

With respect to the balance of hardships and public interest, the Graham Investors' arguments as to these factors are based entirely on false accusations and misrepresentations previously made to and rejected by the District Court. As the District Court properly held, these factors also weigh against a stay. Accordingly, the Graham Investors' motion for a stay pending appeal should be denied.

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[1] "D." refers to the corresponding docket entry in *SEC v. Schooler*, No. 12-cv-02164 (S.D. Cal.) (Curiel, G.).

II. DISCUSSION

A. Likelihood of Success on the Merits

1. Quasi in Rem Jurisdiction

As discussed above, the Graham Investors erroneously argue the District Court failed to determine it had subject matter jurisdiction over the GPs. In doing so, the Graham Investors confuse subject matter jurisdiction with personal jurisdiction. *Quasi in rem* jurisdiction, which applies when a District Court places the property of a non-party in receivership, is a form of personal jurisdiction. *Burnham v. Superior Court of Cal.*, 495 U.S. 604, 621 (1990); *In re San Vicente Medical Partners, Ltd.*, 962 F.2d 1402, 1406 (9th Cir. 1992).

The Graham Investors do not dispute the GPs have minimum contacts with California. Therefore, provided the District Court determined Defendants had control over the GPs and afforded them notice and an opportunity to be heard, it had *quasi in rem* jurisdiction to include them in the receivership and authority to approve procedures for the sale of their properties. *San Vicente*, 962 F.2d at 1406-07; *SEC v. American Capital Investments, Inc.*, 98 F.3d 1133, 1145 n. 17 (9th Cir. 1996).

As an initial matter, immediately upon his appointment, pursuant to 28 U.S.C. § 754, the Receiver filed the Complaint and receivership order in the other judicial districts in which GP properties lie, namely the Districts of Nevada, Arizona, and New Mexico. This extended the District Court's territorial jurisdiction

to include the GP properties in those judicial districts, which, including the Southern District of California, cover all of the GP properties. The Graham Investors do not contend otherwise.

The District Court properly determined Defendants had management and control over the GPs. D. 10, 44, 583, 629, 1003, 1304. Early in the case, the District Court, in finding the SEC had made a *prima facie* case that the GP units sold to investors were unregistered securities, stated:

> Defendants' likely involvement in selling the parcel[s] of land in which the general partnerships are invested, its pivotal operational role with respect to the general partnerships, the fractional nature of the general partnerships' interest in the land, and the apparent use of investors IRA funds, *taken as whole*, satisfy the Court that the SEC has made a prima facie case that the general partnership interests at stake are securities. The Court is especially persuaded by the fractional nature of the interests.

D. 44, pp. 21-22.

In April 2014, the District Court, in finally determining the GP units were securities, made a series of findings regarding Defendants' solicitation of investors, formation of the GPs, investors' dependence on Defendants, and the manner in which Western is "financially intertwined" with the GPs. D. 583, pp. 3-11. These findings are summarized as follows:

- Defendants solicited investors broadly from around the country who did not know each other. GPs generally had 100 or more investors and some had as many as 275 investors.

- Defendants touted their own expertise in real estate transactions and their track record of delivering positive returns. Defendants' salespeople told investors that Defendants would decide when to buy and sell properties and would negotiate the terms.

- Defendants structured the investments such that each GP owns an undivided fractionalized interest in a property with other GPs.

- Lists of investor contact information were sometimes incomplete and outdated.

- The partnership agreements and co-tenancy agreements between GPs that owned fractional interests in the same property were often not signed for a period of months or years after investors transferred their funds to Defendants, meaning investors had no powers or rights during this time and were entirely dependent on Defendants.

- Of the funds raised from investors, 93% was transferred to Western and 7% would remain in the GP accounts.

- No investor votes were actually taken to determine who would act as signatory partners or partnership administrators. Instead, the partnership administrators for all GPs were two individuals who worked under or with Schooler in Western's offices.

- Some investors believed they were "silent partners" and thus relied on Schooler to manage the partnership, decide when to sell, and negotiate sales prices. Defendants' representations at the time of investment led some investors to believe they could sit back and wait for a check to come in.

- During the case, Defendants argued strenuously on behalf of the GPs despite Defendants' insistence that they are completely separate entities from the GPs. Defendants did so until the District Court ordered Defendants to stop. Schooler sent letters to investors explaining the litigation and advising them as to what action they might take. Hundreds of investors have sent the District Court letters in support of Defendants'

arguments. Most of these letters are of the same form and include the same misinformation (*e.g.*, an implication that the Receiver has acted unilaterally without District Court approval).

- Most co-tenancy agreements required that all decisions about a property be made by unanimous consent of all co-tenant GPs. This structure, which was set up by Defendants, made it effectively impossible for any single investor or GP to exercise any power over the GP's main asset – land.
- Investors financed their purchases of GP units in the form of loans owed to their GPs, which amounts the GPs in turn owed to Western. Western collected the payments from investors for the GPs. Western also made loans to GPs that could not pay their operating expenses.
- Schooler covered shortfalls in Western's or the GP's expenses, including on two occasions after the Complaint was filed.

D. 583, pp. 3-11.

Based on these findings, the District Court determined the GP units are securities and granted partial summary judgment in favor of the SEC. *Id.* at p. 16. At the same time, the District Court *sua sponte* reconsidered its prior ruling that the GPs could be released from the receivership on certain terms and conditions. *Id.* at pp. 20-21. The District Court then instructed the parties to file briefs relating to, among other things, its reconsideration and the need to provide GPs with the opportunity to file briefs and appear at a hearing. *Id.*

About three months later, on July 22, 2014, the District Court reiterated its finding that the GPs depend on Defendants. D. 629, p. 5. The District Court also stated the GPs' operations were "not as simple as the Court previously thought them to be." *Id.* at p. 6. The District Court then listed off legal and operational issues of

the GPs that were handled "under Defendants' or the Receiver's management." *Id.* The District Court reiterated the lack of any real power of the GPs due to the co-tenancy structure and undivided, fractionalized nature of the land interests and discussed an example of how an investor who tried to initiate action on behalf of her GP in the form of engaging a broker had failed both procedurally and substantively. *Id.* at pp. 6-7. The Court concluded:

> Based on the foregoing, the Court finds that keeping the GPs in the receivership, under the same type of management that Defendants have historically provided, will promote the orderly and efficient administration of the GP properties for the benefit of investors during the pendency of this litigation. *See Hardy*, 803 F.2d at 1038.

Id. at p. 7.

The District Court later stated that "the GPs were structured by Defendants in such a way as to make them essentially ungovernable and dependent on Defendants to make decisions regarding the properties." D. 1304, p. 22.

Accordingly, the District Court made numerous findings over the course of the litigation that Defendants had management and control over the GPs, both at the time the investments were made, after the GPs were formed, at the time the Complaint was filed, and even after the complaint was filed as Defendants continued to argue aggressively on behalf of the GPs and influence investor views.

Finally, there is no question the District Court provided the GPs with notice and an opportunity to be heard before making any material decisions regarding their primary assets – their land interests.[2] The Receiver sent two letters to all investors during the first six months of the case which advised them of his appointment and directed them to the receivership website for further notices regarding the case. Investors filed hundreds of letters, which the District Court carefully reviewed and considered in its orders. D. 169, 470, 1003, 1304.

The District Court then specifically instructed the Receiver to send notice to the GPs and invited them to file briefs on whether the GPs should remain in the receivership. D. 629. Investors were also notified of the opportunity to appear and address the District Court at a hearing that would be held on October 10, 2014. *Id.* A total of 90 briefs were filed on behalf of 66 GPs and 32 investors requested to speak and presented arguments at the October 10, 2014 hearing. D. 808, pp. 2-3. The Court then determined the GPs would remain in the receivership. D. 1003.

Accordingly, all of the requirements of *quasi in rem* jurisdiction were amply met and the District Court properly placed and kept the GPs in the receivership.

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[2] Between the time the District Court initially placed the GPs in the receivership and ultimately decided to keep the GPs in the receivership, the District Court ordered the Receiver to maintain the *status quo* with the GPs as much as possible. No sale process for GP land interests was even proposed until after the District Court had determined the GPs would remain in the receivership. D. 1056.

2. Waiver

The Graham Investors argue the District Court never squarely addressed whether it had jurisdiction over the GPs (which they incorrectly call subject matter jurisdiction) and only addressed whether the GPs were afforded due process. Supp. Brief, pp. 1-3. The reality is that although the District Court made all of the findings discussed above, which are more than sufficient to establish *quasi in rem* jurisdiction over the GPs, the GPs never specifically challenged the District Court's personal jurisdiction (or *quasi in rem* jurisdiction) over them, even when they were invited to file briefs as to whether they should remain in the receivership.[3] Objections to personal jurisdiction, including *quasi in rem* jurisdiction, are waived if they are not made in the first response. Fed. R. Civ. P. 12(h)(1); *T & R Enterprises, Inc. v. Continental Grain Co.*, 613 F.2d 1272, 1277 (5th Cir. 1980) (Rule 12(h)(1) "advises a litigant to exercise great diligence in challenging personal jurisdiction, venue, or service of process. If he wishes to raise any of these defenses he must do so at the time he makes his first defensive move whether it be a Rule 12 motion or a responsive pleading.") (*quoting* Wright & Miller, Federal Practice & Procedure Civil, Volume 5, 855).

[3] The numerous briefs filed by the GPs with the District Court are generally located between docket entries 663 and 767.

The receivership had been in place for approximately two and half years when the District Court determined the GPs would remain in the receivership and approved procedures for the sale of GP properties. D. 1003, 1069. As noted above, none of the GPs challenged personal jurisdiction at any time. Moreover, none of the GPs sought reconsideration of these orders or appealed them. Accordingly, any objection to the District Court's *quasi in rem* jurisdiction over the GPs was waived.

Even the Graham Investors, a group of approximately 190 investors who do not speak for any GPs, failed to challenge personal jurisdiction (or *quasi in rem* jurisdiction) in their opposition to the Receiver's orderly sale/distribution plan motion (D. 1181) and numerous requests to intervene, instead arguing the GPs were necessary parties, challenging subject matter jurisdiction, and arguing they were denied due process.[4] D. 1235, 1293-1, 1297, 1316-2, 1326.

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[4] The Graham Investors may try to turn their own error on the District Court and argue the District Court should have known they were challenging personal jurisdiction even though they called it subject matter jurisdiction. The District Court, however, went to extensive efforts to address each of the Graham Investors' arguments in a 32-page order. D. 1304. Moreover, the parties never understood the Graham Investors to be challenging personal jurisdiction either, which is evident from the fact it was not addressed in any of the lengthy briefs filed. Therefore, the District Court did not err in not interpreting the Graham Investors' subject matter jurisdiction argument to be a personal jurisdiction argument – no one interpreted it as such. The focus of the Graham Investors' arguments was on due process, which the parties and the District Court fully addressed.

Moreover, allowing the Graham Investors to challenge personal jurisdiction over the GPs on appeal for the first time would severely prejudice the other 95% of investors. The receivership has progressed substantially in reliance on such jurisdiction, including (a) pooling of all funds of Western and the GPs, (b) payments of mortgages, property taxes, administrator fees, and receivership expenses from the pooled fund, (c) modification of the Court-approved sale procedures, (d) substantial work to obtain a waiver of special assessment district penalties, (e) engagement of experts to evaluate GP properties, (f) work to obtain zoning changes and subdivision maps for certain properties, (g) engagement of brokers and efforts to market GP properties, (h) purchase of Phase 1 environmental reports, surveys, and other due diligence materials for certain properties, (i) approvals of sales of two GP properties (with another unopposed sale motion pending, D. 1430), and (j) preparation of financial statements and tax returns for the GPs.

Indeed, at this point it would be impossible to return the 86 GPs to anything close to the state they were in prior to the District Court's approval of the Distribution Plan and pooling of funds (D. 1304), let alone to the condition they were in when the District Court determined to keep them in the receivership almost two years ago (D. 1003). Accordingly, even if the District Court had not properly exercised *quasi in rem* jurisdiction over the GPs, which it clearly did, any objections to personal jurisdiction should be deemed waived.

3. Standing

Finally, the Graham Investors lack standing to challenge personal jurisdiction on behalf of the GPs. Personal jurisdiction not only must be raised in the first response, but it also can only be challenged by the person or entity over whom jurisdiction is asserted. *Marquis Aurbach Coffing, P.C. v. Dofrman*, 2016 U.S. Dist. LEXIS 76493 *8 (D. Nev. June 13, 2016) ("personal jurisdiction challenges are reserved to parties over whom jurisdiction is being exercised."). As noted above, the Graham Investors are approximately 190 investors with interests in the GPs, but they do not speak for the GPs or even constitute a voting majority in any GP.[5] Therefore, they do not have authority or standing to contest the District Court's personal jurisdiction over the GPs.

Accordingly, the District Court properly exercised *quasi in rem* jurisdiction over the GPs, any and all challenges to *quasi in rem* jurisdiction were waived, and the Graham Investors lack standing to assert them regardless. For all of these reasons, the Graham Investors cannot show a likelihood of success on the merits of their appeal.

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[5] Any attempt by the Graham Investors to assert authority over the GPs based on their unauthorized and engineered polling of investors should be rejected for the reasons discussed in Section II.B. below.

B. Balance of Hardships

The Graham Investors' argument regarding the balance of hardships is based entirely on false accusations and misrepresentations. Their numerous false statements include the following:

- The Graham Investors contend the District Court only found that 5% of investors were defrauded. Supp. Brief, p. 13. To the contrary, the District Court not only granted summary judgment on the SEC's fraud claim as to the Stead property (finding that material misrepresentations were made to investors regarding the fair market value of the property), but also found that (a) Defendants marked up the 23 properties by "upwards of 500%" before selling them to the GPs (D. 1081, p. 8), (b) Defendants omitted the amount it paid for the properties from the information provided to investors (*Id.*, p. 7), (c) the sale of investments in all of the GPs was a "single, integrated offering" due to the numerous similarities in Defendants' sale of units across the GPs (D. 1074, pp. 7-8), (d) "all investors were victims of the same scheme" (D. 1304, p. 28), and (e) Defendants' scheme was fraudulent in nature (*Id.*; D. 1409, p. 6).
- The Graham Investors have repeatedly asserted false and grossly inflated figures regarding the fees and costs of the receivership and the amount of money the Receiver has "spent" during the receivership. *See e.g.* Supp.

Brief, pp. 14-15. These figures are not based on any evidence, grossly mischaracterize the facts, and have been rejected by the District Court on several occasions. The truth is that all fees and costs of the Receiver and his professionals are reviewed closely by the District Court and no fees or costs are paid until the District Court expressly approves and authorizes such payments. Moreover, the Graham Investors' complaints about the fees and costs of the receivership are hypocritical. They have cost the receivership estate hundreds of thousands of dollars in fees and costs incurred in producing thousands of requested documents, responding to numerous letters and emails, and addressing their numerous motions and oppositions (in the District Court and this Court), virtually all of which have been denied or rejected. The District Court has admonished counsel for the Graham Investors and Ardizzone Investors for the "repetitive nature of the lawyering" and the costs such conduct has imposed on the receivership estate. D. 1409, p. 14.

- The Graham Investors accuse the Receiver of "collecting millions more by enforcing investors' financial obligations" during the receivership, stating he "pressured investors to pay him millions more . . ." Supp. Brief, pp. 15, 18. The Graham Investors know this is false. As they have observed in other pleadings, the Receiver believed it was inequitable to

continue collecting payments from investors once the financial condition of the GPs and the bleak outlook for investors became clear. Thus, he specifically proposed that collection of such payments be stopped. D 203, pp. 14-15. The District Court did not accept the recommendation and ordered the Receiver to continue to collect payments from investors in order to preserve the *status quo* pending the outcome of the litigation. D. 470, p. 26. Therefore, the Graham Investors knowingly mischaracterize the facts by asserting the Receiver "pressured" investors to pay. The Receiver collected payments from investors at the District Court's express direction.

- The Graham Investors argue "any sums investors paid [the Receiver] under the same GP agreements funded his receivership." Supp. Brief, p. 15. This is completely false and has been roundly rejected by the District Court. In fact, the District Court specifically explained to Defendants and investors who previously asserted the same false accusation that only Western funds and not GP funds were used to pay receivership fees and costs. D. 1003, pp. 7-8. As part of his recommendation that Western and GP funds be pooled for *pro rata* distribution, the Receiver again recommended that collections from investors stop and the District Court approved the recommendation.

D. 1181, 1304. Therefore, since the funds were pooled and receivership fees and costs have been paid from the pooled funds, no further payments have been collected from investors. In fact, the Receiver has returned investor payments made as part of GP capital calls to the investors who made them (with permission from the District Court) because all such capital calls failed to raise the amounts necessary to sustain GP operations.

- Without any evidence, the Graham Investors accuse the Receiver and his counsel of improperly collaborating with the SEC. The Graham Investors can only cite one email from counsel for the SEC in which the SEC asserted its position on an issue. Supp. Brief, p. 16-17. The Graham Investors present no evidence suggesting the email in question resulted in any change to the Receiver's recommendation that the GPs remain in the receivership, which it did not. Indeed, if the Receiver and his counsel were so concerned with pleasing the SEC, the Receiver would not have proposed the GPs be released from the receivership (under certain terms and conditions) in the first place. D. 203. Moreover, both Defendants and the Graham Investors have tried to dismantle the receivership by falsely attacking the Receiver in this regard. The District Court has considered and rejected these arguments, finding no merit in accusations that the Receiver acted unethically or irresponsibly. D. 1296.

- The Graham Investors characterize the Receiver as the SEC's "free expert witness." Supp. Brief, p. 16. This is simply childish name-calling. The SEC never even designated the Receiver as an expert witness in the case.
- The Graham Investors state the District Court "twice ordered" the Receiver to file Standardized Fund Accounting Reports ("SFARs"). Supp. Brief, p. 18. Again, the Graham Investor know this is false. The District Court ordered the Receiver to file SFARs on one occasion and later ordered the Receiver to modify the SFARs he had filed in response to the first order. D. 1304, 1369.

Finally, the Graham Investors tout their "survey" of investor views (Supp. Brief, pp. 13-14), which purports to show that about 1,000 investors (or approximately 30% of the total investors) share their anti-receivership views. The survey, however, is the result of a poll conducted by two of the Graham Investors containing anti-Receiver and anti-District Court language designed to enflame investors and evoke an anti-receivership response. D. 1294, pp. 4-5 (also noting that investors who disagreed with the two investors conducting the poll were either excluded from the poll or sent the poll separately so the full investor distribution list would not see their responses). For these reasons, the District Court has never referenced the survey or given it any consideration in its orders.

If one were to ask investors the following – "should 5% of the investors be allowed to obstruct the entire receivership, unnecessarily run up receivership expenses (which are borne by all investors), and block sales of GP properties such that all investors have to wait years longer to receive distributions and ultimately recover less from their investments?" – investors would undoubtedly say no. The questions posed by the Graham Investors were equally slanted and worded to generate their desired outcome. Therefore, the "survey" is not a reflection of investor interests and should be given no weight.

When you strip away their false accusations, misrepresentations, and transparent attempts to vilify the Receiver, the Graham Investors have no credible argument for why their crusade to delay the receivership at the expense of all investors should be put ahead of the interests of the other 95% of investors, many of whom are elderly and have been waiting four and half years to recover what they can from their investments.

C. Public Interest

The Graham Investors can cite no public interest in granting a stay. Instead, they simply repeat their arguments as to the merits and say the public interest is better served if the *status quo* is preserved. Supp. Brief, p. 20. As the District Court properly held, the public has an important interest in ensuring that "defrauded investor creditors receive a speedy and economic resolution of the receivership

action and at least recover something." D. 1409, p. 6 (quoting *SEC v. Goldfarb*, 2013 WL 4865144, *3 (N.D. Cal. Sep. 12, 2013)). Therefore, the public interest weighs against granting a stay.

III. CONCLUSION

For the foregoing reasons, the Graham Investors' motion for a stay pending appeal should be denied.

Dated: February 21, 2017

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CERTIFICATE OF COMPLIANCE

The foregoing Response to Graham Investors' Supplemental Brief for Review of the Court in Support of Urgent Motion Under Circuit Rule 27-3(B) Appellants' Motion for Stay Pending Appeal (D.E. 12) complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because:

This brief contains 4,366 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(6) because it was prepared in a proportionally spaced typeface using Microsoft Word 2007, in font size 14, Times New Roman.

Dated: February 21, 2017

ALLEN MATKINS LECK GAMBLE MALLORY & NATSIS LLP

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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 CM/ECF system on February 21, 2017. 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.

Dated: February 21, 2017

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