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

**APPELLANTS' REPLY TO
SECURITIES AND EXCHANGE COMMISSION'S RESPONSE
TO SUPPLEMENTAL BRIEF IN SUPPORT
OF URGENT MOTION FOR STAY PENDING APPEAL**

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I. Introduction

In this reply, Appellants address Appellees' contentions that (1) the District Court has *quasi in rem* jurisdiction over the 87 general partnerships ("GPs") in the receivership and (2) Appellants did not object to the exercise of that jurisdiction. Appellants address the remaining issues that only the receiver, Thomas C. Hebrank ("Hebrank"), raised in their reply to his response. Those remaining issues are irreparable injury, hardship to third parties, and public interest.

Neither Appellee addresses Appellants' core contention in their supplemental brief: the District Court applied due process standards rather than jurisdiction standards in holding it had jurisdiction over the GPs. Neither tried to support the District Court's statement that it "carefully considered," "evaluated" and "rejected" Appellants' argument it lacked subject matter jurisdiction in four designated pages of its May 25, order. D.[1] 1409 at 9, ll. 14-16.

Instead, Appellees propose a new theory, one never presented to the District Court or this Court during the first round of briefing. Despite their decades of experience in SEC receivership cases, neither the SEC nor Allen Matkins understood the issue on which jurisdiction turns until now. And what was the epiphany? Both suddenly realized Appellants used the wrong term to object to the District Court's lack of jurisdiction over the GPs. Neither explains why they failed

[1] "D." refers to the corresponding docket entry in *SEC v. Schooler*, No. 12-cv-02164 (S.D. Cal.); "D.E." refers to docket entries with this Court. The pagination follows the page numbers as designated by CM/ECF.

to raise this issue before the District Court or during the first round of briefing.

II. The District Court Lacks Jurisdiction over the GPs

A. Appellants Did Not Waive Their Objection to the District Court's Lack of Jurisdiction over the GPs

Appellees contend the District Court's jurisdiction over the GPs is *quasi in rem* jurisdiction, a form of personal jurisdiction, and Appellants failed to correctly object to it. This theory has flaws within flaws.

To begin with, Appellees have misconceived the line of cases upon which they rely, *Cargill, Inc. v. Sabine Trading & Shipping Co., 756 F.2d 224 (2d Cir. 1985)* and *Burnham v. Superior Court of Cal.***,** 495 U.S. 604 (1990). Both are progeny of *Shaffer v. Heitner,* 433 U.S. 186, 213 (U.S. 1977). *Shaffer* created a due process shield to protect nonresidents from being forced to litigate a claim in the forum state unrelated to the nonresidents' property located in that state. It held the nonresident could not be forced to defend such a claim based solely on *quasi in rem* jurisdiction. The plaintiff would still have to satisfy due process requirements for *in personam* jurisdiction. Hence, in this sense, *Shaffer* created a link between *quasi in rem* jurisdiction and due process. That said, Appellees have tried to remold *Shaffer* into a defense that bears little resemblance to its holding.

The dynamic that triggers *Shaffer* is a lawsuit against a nonresident. In this case, Hebrank might have triggered *Shaffer* by suing a nonresident investor using *quasi in rem* jurisdiction based on the investor's ownership of property located

within California. *Shaffer* holds that a California court would not have jurisdiction unless due process requirements for *in personam* jurisdiction are also met.

The SEC relies on *Cargill* in asserting Appellants waived *quasi in rem* jurisdiction. *Cargill* involved an attachment of a nonresident's property within the forum state. In *Cargill*, the nonresident failed to object to the exercise of the court's *quasi in rem* jurisdiction over him in relation to the attachment. The Seventh Circuit held: "By failing to raise the issue in their answer, appellees here have waived any objection to the exercise of quasi in rem jurisdiction they may have had." 756 F.2d at 228. What does this mean? The holding and reasoning of *Cargill* indicates the nonresident who does not claim he is exempt from any personal jurisdiction in his answer waives jurisdiction in relation to the attachment. In that case, the nonresident must litigate the *attachment* claim under the court's *quasi in rem* jurisdiction. *Cargill* explains:

> Here, appellees' counterclaim is based solely on damages that they allegedly have incurred through the attachment of their assets in the United States. It does not arise from the transaction that is the subject of appellant's claim but, rather, from the method by which appellant obtained jurisdiction. Under these circumstances, *appellees have not destroyed the essentially quasi in rem nature of the action and cannot be said to have consented to complete jurisdiction under general waiver principles*. (emphasis added)

Id. at 229. Appellees erroneously assert the nonresident waives the right to dispute the claim on the merits, e.g., in *Shaffer* whether the attachment was proper and here whether there grounds existed to include the GPs in the receivership. *Shaffer* was

fashioned as a shield to protect nonresidents, not as a sword to divest them of their substantive claims. Appellants did not seek a holding that the District Court lacks jurisdiction over them. They sought the reverse: to be treated as parties to this case. Hence, *Shaffer* and its progeny have no application here.

Setting aside the first flaw, the next link in Appellees' legal reasoning reveals another flaw which implies desperation. Appellees contend Hebrank's October 2012 letter triggered a *Shaffer-Cargill* waiver. *Cargill* holds that the failure to raise lack of jurisdiction in the *answer* to the complaint raises the possibility of a waiver under Fed. R. Civ. P. 12(h)(1). *Id*., at 229. This rule does not apply to letters.

And then there is the third flaw: Appellants have waived nothing. Appellants have persistently objected to the inclusion of the GPs in the receivership on both jurisdictional and due process grounds. Appellants' proposed complaint in intervention alleged in detail that the inclusion of the GPs in the receivership violated their due process rights. D.1229-1 at 6-7. Before they were permitted to intervene, Appellants filed opposition to Hebrank's motion to liquidate the GPs and sell GP realty *on both jurisdictional and due process grounds*. They relied on this Court's language in *SEC v. Am. Capital Invs*., 98 F.3d 1133, 1145, n. 17 (9th Cir. 1996), which addresses both grounds. D. 1293-1 at 5. The District Court's order confirms it understood Appellants were objecting to its exercise of jurisdiction over the GPs since it *quoted* Appellants' objection on jurisdictional grounds:

> And while *American Capital Investments*, 98 F.3d at 1145 n.17, does cite 2 *Clark on Receivers* §§ 482, 491, for the proposition that equity receivers "can conduct a judicial sale of real property that *is properly within their 'possession and control'* and within the court's territorial jurisdiction, where all parties of interest have been brought before the court," Aguirre Investors cite no authority to support the proposition that investors should be understood to be parties of interest (emphasis added).

D. 1304 at 15. In short, the District Court acknowledged Appellants' objection to its jurisdiction, but held Appellants lacked the standing to raise it.

This was only the first of Appellants' multiple objections on jurisdictional grounds. Prior to the District Court's November 29, 2016, order (D. 1409), Appellants argued the District Court lacked subject matter jurisdiction over the GPs—lacked control over them—four more times. Ds. 1326 at 5-18; 1351 at 6 and 12-16; 1365; and 1370. The District Court's orders have been appealed.

As a fourth flaw, Appellees' contention that the objection must be phrased as an objection to "*quasi in rem* jurisdiction" conflicts with the terminology this Court has used to refer to the a court's jurisdiction over the assets held in a receivership, which include: subject matter jurisdiction, *Am. Capital Invs.*, 98 F.3d at 1141 ("a sale confirmation order issued without subject matter jurisdiction may be set aside as void"); *quasi in rem* jurisdiction, *Id.*, at 1133; *in rem* subject matter jurisdiction, *Beck v. Fort James Corp*., 421 F.3d 963, 971 (9th Cir. 2005) and *in rem* jurisdiction, *SEC v. ING USA Annuity & Life Ins. Co.*, 360 Fed. Appx. 826, 828 (9th Cir. 2009). Hence, litigants are not confined to one phrase to refer to this form of jurisdiction.

As a fifth flaw, Appellees contention leads nowhere. Appellees still concede

they must prove the defendants had control of the GPs when the SEC filed its case:

> Therefore, *provided the District Court determined Defendants had control over the GPs* (emphasis added) 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)

D.E. 40 at 6. There are 3,000 other investors who may also question the District Court's jurisdiction over the GPs. None have sought to intervene. No waiver assertion can be made against them. Hence, unless the District Court obtained control of the GPs from the defendants, it is acting without jurisdiction.

As a sixth flaw, both *Shaffer* and *Cargill* place heightened due process requirements on the party asserting *quasi in rem* jurisdiction. Hence, Appellees argue due process issues. The ten-page limit prevents Appellants from responding to those arguments in this brief. We therefore respectfully refer this Court to our earlier briefs in this appeal (D.Es. 12 at 18-20; 18-1 at 6-9) and the briefs in the Ardizzone appeal where due process and Local Rule 66.1 issues were addressed. Appeal No. 16-56362, D.Es. 11 and 16.

B. The District Court Lacks Jurisdiction over the GPs Because Appellees Failed to Prove Defendants Controlled the GPs when the Complaint Was Filed

Appellees have the burden to establish the District Court has jurisdiction over the GPs. *Kelly v. Wengler*, 822 F.3d 1085 (9th Cir. 2016). This Court reviews *de novo* the issue of law inherent in ascertaining the jurisdictional limits to the

District Court's power in equity receivership proceedings. *Am. Capital Inv.*, 98 F.3d at 1142. The SEC must overcome two undisputed facts to prove that defendants controlled the GPs: the investor-partners in each GP collectively (1) own 94% of the GPs (D. 852-1 at 4) and (2) hold 100% of the voting power. D. 1293-3 ¶ 15. The terms of the GP agreements empowering investors with control are quoted in the declaration of Appellants' counsel, D.E. 18-2, ¶¶ 4- 5, Ex. 2.

The District Court never addressed whether defendants controlled the GPs in the context of its jurisdiction over them. Instead, the SEC got the parties to stipulate to subject matter jurisdiction (D. 174), an unlawful and void stipulation. *Singer v. State Farm Mut. Auto. Ins. Co.*, 116 F.3d 373, 376 (9th Cir. 1997). The control issue arose three times in the context whether the GPs were securities under the *first* factor of *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981). That factor is satisfied if an agreement "leaves so little power in the hands of the partner… that [it] in fact distributes power as would a limited partnership." *Id.* at 424.

The SEC first asserted that the GPs were *de facto* limited partnerships in its motion for a preliminary injunction, arguing that "Defendants control [the GPs] and their assets." D. 3 at 31, l. 1. This contention, if true, would bring this case within the scope of *In Re San Vicente Med. Partners, Ltd*. 962 F.2d 1402 (9th Cir. 1992), where the defendant controlled San Vicente, the limited partnership, and its assets. D. 3 at 31, l.15. But the District Court held the SEC's claim that defendants

controlled the GPs as *de facto* limited partnerships "missed the mark" and gave multiple reasons why they lacked it. D. 44 at 7-8.

The District Court addressed the issue a second time when defendants moved to dismiss the SEC complaint. The District Court held the SEC failed to allege that defendants controlled the GPs. D. 212 at 6, l. 24. It again relied upon the express terms of the GP agreements. *Id*.

The issue arose a third time when the SEC and defendants sought summary judgment on whether the GPs were securities. Ds. 542 and 563. This time, the SEC abandoned its twice rejected theory that the GPs were *de facto* limited partnerships. Instead, it argued (1) defendants controlled the GPs *during the offering period*, (2) the GP agreements were not effective until after the close of the GP offering, and (3) control *during the offering* was the test for deciding whether the GPs were securities. Ds. 552 at 18-22 and 563-1 at 17-20. The District Court agreed. It explained that control did not pass to investors until the GP and the co-tenancy agreements became operative. D. 583 at 15-16. The SEC agrees with this analysis.[2] But this fact does not support Appellees' argument. Hebrank's June 20, 2013, report concedes all partnerships had closed and the properties had been transferred to the GPs before 2012 (D. 203 at 3-8), except for the Stead property held by three

[2] Referring to the same order, the SEC it noted: "In that latter ruling, the district court reasoned that because the written GP agreements, by their terms, were not effective until months or years after the first investment was made, they left the investors dependent on defendants' managerial control." D.E. 13 at11.

GPs. *Id*., at 6. Hence, at the relevant time for jurisdiction—when the SEC filed its case—investors controlled the GPs. *San Vicente*, 962 F.2d at 1407.

C. The SEC's Attempt to Establish that the GP Agreements Were Securities under Other Theories Fails

As a last gasp, Appellees contend—with no authority—that the District Court has jurisdiction over the GPs, because they were held to be securities. In support of its contention, the SEC reargues in its second opposition (D.E. 39 at 4) the same two points it argued in its first opposition. D.E. 13 at 10-11. For his part, Hebrank cherry picks various comments in the same order (D. 583) which it tries to re-spin as findings. D.E 40 at 7-9. But the holding in that order remains the same: control shifted to investors before the SEC filed its case. D. 583 at 15-16.

In essence, Appellees contend a receiver may be appointed to seize any security that changes hands during an alleged violation of the securities acts. This unprecedented extension of the District Court's *quasi in rem* jurisdiction would mean that a receiver could be appointed in every SEC case, since every SEC case involves a security changing hands. A security that had come to rest in investors' possession decades earlier, such as the GP agreements here, would be subject to seizure and divestment. All securities would forever be at risk of a receivership. The SEC cites no case that even hints at supporting such a theory.

Moreover, the SEC's newly minted theory would upend the principles of comity that state and federal courts yield *in rem* or *quasi in rem* jurisdiction to the

court which first has control over the property. The SEC's theory that a court has jurisdiction over any security that changed hands during an alleged violation of the securities acts would create a unique caveat to this venerable principle. It would provide the courts with two potentially conflicting standards to decide which court had jurisdiction over the same assets. It would no doubt compromise judicial harmony through "state and federal judicial systems attempting to assert concurrent control over the *res*." *Sexton v. NDEX West*, 713 F.3d 533, 536 (9th Cir. 2013).

D. Appellants Have Standing To Challenge the District Court's Jurisdiction

Finally, Hebrank argues that Appellants cannot object to the District Court's assertion of personal jurisdiction over the GPs. To begin with, this argument is premised on erroneous reading and misapplication of the principles of *Shaffer* and *Cargill* as discussed above. Further, this Court has articulated broad standards for determining whether a person affected by a receivership has standing to appeal the District Court's order. See, *SEC v. Wencke,* 783 F.2d 829, 834 (9th Cir. 1986). In this case, the District Court's orders void the GPs in which Appellants are partners and then redistribute those assets to third parties. In short, they nullify Appellants' property rights in those GPs and their assets. Appellants submit their standing to raise these issues could not be clearer.

Dated: February 24, 2017

Respectfully submitted,

By: /s/ Gary J. Aguirre
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Attorney for Appellants .

ATTACHMENT 1,
INTERVENORS-APPELLANTS

Susan Graham, Alfred L. Pipkin, Alfred L. Pipkin, IRA, Allert Boersma, Arthur V. and Kristie L. Rocco Living Trust, Arthur V. Rocco, Baldwin Family Survivors' Trust, Barbara Humphreys, IRA, Beverly & Mark Bancroft, Beverly A. Bancroft, IRA, Bruce A. Morey IRA, Bruce A. Morey, Bruce R. Hart IRA for Bruce R. Hart and Dixie L. Hart, Carol D. Summers, Carol Jonson, Catherine E. Wertz IRA, Catherine E. Wertz, Cathy Totman, IRA, Charles Bojarski, Chris Nowacki, IRA, Cindy Dufresne, Craig Lamb, Curt & Janean Johnson Family Trust, Curt & Janean Johnson, jointly, Curt Johnson, Curt Johnson, Roth IRA, Cynthia J. Clarke, D & E Macy Family Revocable Living Trust, D.F. Macy IRA, Daniel Burns, Daniel Knapp, Darla Berkel IRA, Darla Berkel, Daryl Dick, David and Sandra Jones Trust, David Fife IRA, David Haack IRA, David Haack, David Karp IRA, David Kirsh, David Kirsh, Roth IRA, David Kirsh, Traditional IRA, Debra Askeland, Deidre Parkinen, Dennis Gilman, Dennis Gilman IRA, Diane Bojarski, Diane Gilman, Donna M. and Richard A. Kopenski Family Trust, Donna M. Kopenski, IRA Roth, Douglas G. Clarke, Douglas Sahlin IRA, Eben B. Rosenberger, Edith Sahlin IRA, Edward Takacs, Ellen O'Brien, Elizabeth Lamb, Norling, Eric W. Norling, IRA, Gary Hardenburg, Gary Hardenburg, Roth IRA, Gene Fantano, George Klinke, IRA, George Trezek, Gerald Zevin, Gerald Zevin, IRA, Gwen Tuohy, Gwenmarie Hilleary, Henrik Jonson, Henrik Jonson, IRA, IDAC Family Group LLC, Iris Bernstein IRA, James J. Coyne Jr. Trust, Janice Marshall, Janice Marshall, IRA, Jason Bruce, Jeffrey Merder, IRA, Jeffrey J. Walz, Jeffrey Larsen, Jeffrey Merder, Jennifer Berta, Jim Minner, Joan Trezek, John Jenkins, John and Mary Jenkins Trust, John and Mary Jenkins Trustees, John Lukens, John Lukens, IRA, John R. Oberman, Joy A. de Beyer, Roth IRA, Joy A. de Beyer, Traditional IRA, Joy de Beyer, Juanita Bass IRA, Juanita Bass, Judith Glickman Zevin, IRA, Judith Glickman Zevin, Judy Knapp, Karen Coyne, Karen J. Coyne IRA, Karen Wilhoite, Karie J. Wright, Kimberly Dankworth, Kirsh Family Trust UTD, Kristie

ATTACHMENT 1,
INTERVENORS-APPELLANTS

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CERTIFICATE OF COMPLIANCE

The foregoing Reply to U.S. Securities & Exchange Commission's Response to Supplemental Brief in Support of Urgent Motion for Stay Pending Appeal complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because: This brief contains 2,698 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 24, 2017

Aguirre Law, APC

By: /s/ Gary J. Aguirre
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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing reply 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 24, 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 24, 2017 Aguirre Law, APC

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