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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

INVESTORS' OPPOSITION TO APPROVAL OF SALE OF JAMUL VALLEY PROPERTY

Date: July 15, 2016
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

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I. Introduction

The 192 investors ("Investors") filing this motion are partners in one or more of the 87 general partnerships ("GPs") in the receivership.[1] The term "investors" as used in this brief refers to all 3,300 purchasers of interests in the 87 GPs. Movants contend the motion to approve the sale of the Jamul Valley property must be denied on two separate grounds: (1) the Court lacks subject matter jurisdiction to convey title to the Jamul Valley property and (2) the Receiver seized the Jamul Valley property from the GPs who own it and their partners in violation of their constitutional rights.

One very significant case—the most recent in the *Wencke* progeny—is the Ninth Circuit decision in *SEC v. Ross,* 504 F.3d 1130 (9th Cir. 2007). That case involved a similar factual pattern to *SEC v. Wencke*, 783 F.2d 829 (9th Cir. 1986); the receivers in both cases sought disgorgement from the nonparty. While *Wencke* affirmed the district court on the grounds that the third party (deLusignan), *Ross* reversed the district court on the grounds the summary proceeding was inadequate compliance with due process. In Ross, supra, the court found the nonparty should have been served and made a party to the case. Investors believe that this case presents more compelling facts than *Ross*.

II. The Court Never Acquired Jurisdiction over the Jamul Valley Property and Thus Any Order Approving the Sale of the Property Would Be Void

If the Court lacks jurisdiction to sell the Jamul Valley property, any order purporting to sell the property would be void. In *SEC v. Am. Capital Investments*, 98 F.3d 1133, 1141 (9th Cir. 1996), the Ninth Circuit cited *Voorhees v. Jackson,* 35 U.S. 449, 477 (1836) for the principle: "A 19th century Supreme Court case supports the proposition that a sale confirmation order issued without subject matter jurisdiction may be set aside as void, notwithstanding the absence of a stay." The Ninth Circuit also relied on *Voorhhees* for this principle: "If there is such a 'want of jurisdiction, the proceedings are void and a mere nullity, and confer no right . . . and may be rejected when collaterally

[1] The names of the investors filing this opposition are listed in Attachment 1 filed herewith.

drawn into question.'" *Id.* The lack of subject matter jurisdiction may be raised directly on an appeal from an order granting a motion to sell (*American Capital Investments*, 98 F.3d at 1141) and thus directly by this brief opposing the Receiver's motion to sell the Jamul Valley property.

In this case, Investors contend that any order purporting to sell the Jamul Valley property would be void, because the Court lacks subject matter jurisdiction over that property. On the SEC's *ex parte* application, the Court *initially* concluded it had subject matter jurisdiction on the premise that Western controlled the 87 GPs and thus the 36 real properties the GPs owned. Dkt. No. 10 at 1, 2, 4, and 11-18. In its application for the appointment of a temporary receiver, the SEC offered no evidence, only unsupported argument that Western controlled the GPs' realty. In its September 6, 2012, brief the SEC argued: "The partnership agreements state, however, that Western is a non-voting partner. This gives the appearance that Western does not control the GP. But in reality it does." Dkt. No. 3-1 at 4, note 3. This bald contention—unsupported by evidence—was the basis for the argument that the GPs' realty should be included in the receivership.

The SEC has consistently argued, as opposed to offering proof, the Receiver acquired control of the GPs by stepping into Western's shoes. On this point, the Court's July 22, 2014, order reads: "The SEC asserts that 'investment contracts,' by definition, involve promoters who 'manage, control, and operate the enterprise,' and that, '[b]ecause of this dependence, the [R]eceiver, who has merely stepped into Western's shoes, is necessary to ensure the continued management, control, and operation of the enterprise.'" Dkt. No. 629 at 4, 1-5.

The Court has relied extensively on *In Re San Vicente Med. Partners Ltd*. 962 F.2d 1402 (9th Cir. 1992) throughout these proceedings and more recently on *American Capital Investments*, *supra*, as a basis for its jurisdiction over the GPs and their assets. However, both cases hold that a Receiver can only take possession or control of the assets in the possession or control of the defendants at the time the Court appoints a receiver. *American Capital Investments*, 98 F.3d at 1136; *San Vicente*, 962 F.2d at 1405. See also:

SEC v. Tanner, 2006 U.S. Dist. LEXIS 25766 (D. Kan. Apr. 26, 2006)("The purpose of the statute [28 U.S.C. § 754] is to give the appointing court jurisdiction over property in the actual or constructive possession and control of the debtor, wherever such property may be located.")

As discussed in the next section, this limitation (the receiver steps into the shoes of the defendant) is a core tenet of receivership law. The leading treatise on receivership law, 2 Clark on Receivers (3d ed. 1992), explains:

> The receiver can sell only the right, title and interest of the defendant whose property has been placed in the hands of the receiver or the interest of proper parties to the cause…A sale made by a receiver being a judicial sale, the rule is well settled that a sale of real estate under judicial proceedings concludes no one who is not in some form a party to such proceedings.

Clark, § 482 at 785.

The premise that Western had possession and control of the GPs when the Court appointed the Receiver cannot be squared with the Court's findings. Those rulings clearly establish that Western lacked both possession and control of the GPs when the Receiver was appointed. Those rulings are binding on the Receiver since he has been a party in this case from the outset, but do not bind Investors since they were not parties. *Hansberry v. Lee*, 311 U.S. 32, 40-41 (US 1940). (Generally, "a judgment does not bind nonparties.")

The Court first expressed its conclusion that Western lacked possession and control over the GPs when it rejected the SEC's contention that investors' interests in the GPs were in essence limited partnership interests. In reaching this conclusion, the Court pointed to the terms of the partnership agreements which empowered its partners:

> Defendants submitted a sample, representative partnership agreement with their emergency motion to dissolve the TRO. (*See* Doc. No. 14-1.) The agreement gives general partners the right to access the partnership's books.3 (*Id.* at ¶ 2.6.) It provides that a majority in interest may vote to remove the Signatory Partners. (*Id.* at ¶ 4.2.3.) A majority in interest must also vote to admit new partners to the partnership. (*Id.* at ¶ 4.5.) All partnership decisions must be made by a majority in interest vote. (*Id.* at ¶ 5.1.2.) "Any Partner, including Non-Voting Partners, may request a vote of

> the Partnership on any matter relevant to the business and operation of the Partnership." (*Id.* at ¶ 5.2.2.) Partners' contact information, under the agreement, is circulated to all members. (*Id.* at ¶ 5.4.) While Defendants are appointed partnership administrators under the agreement, they may be terminated, with or without cause, by a majority vote. (*Id.* at 7.1.4.) A majority in interest.

Dkt. No. 44 at 9, 14-24. Based on this concrete evidence, the Court concluded: "The partnership members don't necessarily have 'so little power' that they are effectively limited partners." Dkt. No. 44 at 10, 4-5.

In its August 13, 2013 order, the Court noted the Receiver had argued the GPs controlled themselves. On this point, the order reads: "The Receiver further notes that, because the GPs are under the sole management and control of the GPs, Defendants' basis for seeking relief on behalf of the GPs is unclear." Dkt. No. 470 at 5, 26-28. The Court also expressed its view on this issue: "[I]t is clear to the Court that–while investors may have the legal authority to manage their GPs' affairs–investors do not fully understand that authority." *Id*., at 22, 19-20.

In granting the SEC's motion that the GPs were unregistered securities (Dkt. No. 583), the Court did not reverse its earlier findings that Western lacked control over the GPs. Rather, the Court noted its rulings focused on the control of the GPs at two different times. The Court explained: "As a result of this additional evidence, it became clear that investors did not have the right to exercise control of the GPs *at the time that they invested with the Defendants*. Ultimately, the Court's prior rulings are not inconsistent because they are based upon different facts or evidence (emphasis added)." Dkt. No. 840 at 5. In like manner, the Court's April 25, 2014, order explained: "Nonetheless, bank accounts were opened in the names of prospective GPs upon an initial investment. *Investors did not control these bank accounts until the Partnership Agreements, which provided for the appointment of signatory partners, became effective* (emphasis added)." Dkt. No. 583 at 6, 20-23.

III. Any Order Approving the Sale of the Jamul Valley Property Would Be Void, Because the GPs Owning that Property and Their Partners Are Nonparties

The Receiver proposes to sell the Jamul Valley property, pool the proceeds of the sale, use proceeds to pay receivership costs (including his fees), and then distribute the funds pro rata to all investors, contrary to the terms of the GP agreements. Neither the GPs owning the Jamul Valley property nor the partners in those GPs are parties to this case. Further, neither the GPs nor their partners have been permitted to participate in this case as required by the Due Process Clause to the Fifth Amendment. This denial of due process is further aggravated by the fact the Receiver controls the GPs and he is the actor who actively violates their due process rights. Further, all investors have been deprived of their rights to take control of the GPs so they can assert the GPs' due process rights.

We turn now to the leading authority on U.S. receivership law, 2 Clark on Receivers (3d ed. 1992) ("Clark"), which this Court and the Ninth Circuit have repeatedly cited on the relevant issues. In its May 25, 2016, order the Court quotes from *San Vicente, supra*, and *American Capital Investments, supra,* where the Ninth Circuit quotes Clark for the principle, "a court of equity having custody and control of property has power to order a sale of the same in its discretion." Dkt. No. 1304 at 9 and 13. The Court's reliance on this language in approving the sale of the Jamul Valley property would be misplaced.

The quote from Clark assumes the Receiver acquired the asset being sold from a party in the case and that party owned the asset, possessed it, or controlled it. That is not the case here. The Court has never found that the Defendants had either possession or control of the Jamul Valley property when the Court appointed the Receiver. Indeed, as discussed above, the Court's orders hold the opposite: Western did not control the GPs when the Receiver was appointed. The evidence Defendants did not own the GPs, including the three owning the Jamul Valley property, is indisputable. As a matter of law, the GPs own the 36 properties. Under these circumstances, the Court lacks the power to order the sale of the property.

The quotes from Clark in *San Vicente*, *American Capital Investments* and this Court's May 25 order (Dkt. No. 1304 at 9 and 13) need to be placed in context. When read in the context of the relevant portions of the two preceding paragraph's in the treatise, the Court's quote from Clark reads:

> The receiver can sell only the right, title and interest of the defendant whose property has been placed in the hands of the receiver or the interest of proper parties to the cause. …
>
> A sale made by a receiver being a judicial sale, the rule is well settled that a sale of real estate under judicial proceedings concludes no one who is not in some form a party to such proceedings. A proceeding in rem may conclude all parties because all persons having an interest are deemed parties.
>
> *It is generally conceded that a court of equity having custody and control of property has power to order a sale of the same in its discretion. The power of sale necessarily follows the power to take possession and control of and to preserve property, resting in the sovereignty and exercised through courts of chancery, or courts having statutory power to make the sale* (emphasis added).

Clark, § 482 at 785. A few pages later, Clark returns to this point:

> Neither courts of equity nor common law courts can deprive a man of his property, or of his rights by the judgment or decree of a court, without an opportunity being given him of defending the right. Thus opportunity is afforded, by a citation or notice to appear, actually served; or constructively, by pursuing such means as the law may, in special cases regard as equivalent to personal service…A decree in chancery for the conveyance of land has never yet been held to come within the principle of proceedings in rem, so far as to dispense with the service of process on the party.

Id., § 482(a) at 788.

Finally, Clark speaks on who can sell the property when the owner has lost control, but still has title:

> § 488 Owner's power, if any, to sell property in hands of receiver.
> There would seem to be no objection to the sale by one whose property is in the hands of a receiver of all his right, title and interest to such property subject, however, to the control and possession of the appointing court.

Id., § 488, at 799.

These statements by the recognized authority on the law of receivership raise a threshold question: what legal principle supports the Court's sale of property owned by innocent third parties who are not parties to this case? Clark addresses this question in the same chapter as the quote in *American Capital Investments*, *San Vicente* and this Court's May 25 order: "Neither the court nor its officer, whether master or receiver, or other officer, gives a legal title to the purchaser because neither the court nor its officer has a legal title to give unless the owner has made a deed to the officer of the court." *Id*., § 487 at 794.

This takes us to the second question: if neither the Court nor the Receiver has legal title, on what theory can the Court and the Receiver sell the property? Clark continues on the same paragraph:

> A court of equity acts by a process of injunction against the owner and against the parties to the suit and protects the purchaser against interference and assures him a quiet title and quiet enjoyment. In addition to the court acting in personam, its records are constructive notice that the court has made orders concerning the res in its possession and control.

Id., at 794-95. The Ninth Circuit is in sync with Clark: "A court of equity acts by a process of injunction against the owner and against the parties to the suit and protects the purchaser against interference and assures him a quiet title and quiet enjoyment." *American Capital Investments*, 98 F.3d at 1144.

In this case, the Court proposes to sell property which the GPs owned and controlled when the Court appointed the Receiver. Again, Clark instructs neither the Court nor the Receiver can take assets from a nonparty who claims rights to possession or title:

> Title or the right to property cannot be tried in a contempt proceeding. What is meant by this well settled rule is that a court in such a proceeding cannot by its order take property from the actual possession of a stranger to the action in which a receiver is appointed who claims title to it or right to its possession.

Clark, § 636 at 1049.

In this case, at the invitation of the Receiver, the Court would nonetheless confirm the sale of property though the GPs are not parties in this case. Under these circumstances, Clark concludes the order would be void for the following reasons:

> Such an order would be void, because one in possession of property, cannot be dispossessed without due process of law, which means an appropriate action brought against him, whereupon issues are framed and a regular trial before a court or jury, wherein his title or right to retain possession may be determined, and a proceeding in contempt is not such an action.

Id. For the Court to obtain the jurisdiction to sell the property, it must require the owners be made a party to the case. On this point, Clark again instructs:

> Where property in the hands of a receiver is claimed by another, the right may be tried by proper issues at law, by a reference to a master or otherwise as the court in its discretion may see fit to direct. Where property in possession of a third party is claimed by the receiver, *the complainant in the receivership suit must first make such person a party* ***by*** *amending the bill or the receiver must proceed against him* ***by*** *suit in the ordinary way* (emphasis added).

Id. Clark addresses the same issue in a later section of the treatise and reaches the same conclusion:

> If the property is in the possession of a third party, who claims the right to retain it, the receiver must either proceed by suit under orders of the appointing court to try the right to it, or the complainant or petitioner in the main suit should make such third person a party to the main suit and apply to have the receivership extended to the property in the hands of such third person, so that an order for the delivery of the property may be made which will be binding on the third person and which may be enforced by process of contempt or otherwise enforced if the order is not obeyed.

Id., § 397 at 685.

Clark also advises the third party may be entitled to a jury trial if he is entitled to plenary proceedings. On this point, his treatise reads:

> An intervention proceeding is purely an equitable proceeding although in an intervention proceeding questions of fact may be submitted to a jury by the court of equity. No jury is an essential part of an intervention proceeding, yet a jury may be an essential part of a plenary proceeding at law.

Id., § 532(b) at 848.

The holdings of the Ninth Circuit on federal receivership cases are consistent with the points quoted above from Clark. In *United States v. Arizona Fuels Corp.*, 739 F.2d 455 (9th Cir. Ariz. 1984), the court considered the claim of a third party creditor (Tenneco) that was entitled to plenary proceedings in connection with an offset claim. Tenneco asserted the claim as an affirmative defense to the Receiver's claim Tenneco was holding cash owned by the receivership. The Ninth Circuit summed up Tenneco's baseless claim: "Tenneco's argument that the June 1 advance funds were not 'receivership assets' is predicated on a proposition for which it offers no support, and we find none: that a setoff relates back to the date when the creditor obtained the assets offset against the debtor." *Arizona Fuels Corp.*, 739 F.2d at 457. The court also concluded: "summary proceedings are appropriate to determine right to possession, although not ultimate rights to title or ownership." *Id.*, at 459.

The court distinguished Tenneco's claim, involving possession of funds, from a third party's claim it controlled and owned an asset. The court summarized Tenneco's legal contention: "Tenneco cites cases holding that, in particular circumstances, a receiver must file a plenary action against a third party who possesses claimed receivership property, rather than invoking summary proceedings ancillary to the main action." *Id.*, at 458. The Ninth Circuit noted, "This is true when, for example, a receiver asks the court to determine the ultimate merits of the parties' claims to the property," citing *Dold Packing Co. v. Doermann*, 293 F. 315, 331 (8th Cir. Neb. 1923). In turn, *Dold*, 293 F. at 331, relied upon and quoted the Supreme Court in *Davis v. Gray*, 83 U.S. 203 (U.S. 1873) for this principle: "Where property, in the possession of a third person, is claimed by the receiver, the complainant must make such person a party by amending the bill, or the receiver must proceed against him by suit in the ordinary way."

In *SEC v. Universal Financial*, 760 F.2d 1034 (9th Cir. 1985), the defendants issued investors promissory notes and "agreed to pay Investors monthly interest and to repay the principle at maturity." *Id.*, at 1036. "The Receiver proposed the plan that placed Investors' claims into several classes in accordance with the receiver's theory of the legal

effect of different types of transactions." *Id*., at 1036-37. "At the suggestion of the district court, counsel for Investors and the Receiver agreed to try two so-called 'test cases' in order to expedite the litigation." *Id*., at 1037. The investors contended "that summary jurisdiction is unconstitutional where an adverse claimant presents a substantial claim that he, rather than a receiver or trustee, is the owner of an intangible chose in action." *Id*. the Ninth Circuit rejected the investors' contention, noting they had effectively received plenary proceedings:

> We agree with the Receiver, however, that the distinction between summary and plenary proceedings was of no consequence here because the district court afforded Investors virtually all of the procedural protections which would have been available in plenary proceedings…. Investors were allowed extensive discovery, including the right to take depositions, and were permitted to file numerous briefs and exhibits in connection with the test cases. The court applied the Federal Rules of Evidence and the Federal Rules of Civil Procedure. Although there was no formal complaint or answer, Investors cannot seriously claim that they lacked notice of the nature of the proceedings. Because Investors cannot explain how the summary proceedings differed from the process they would have received in a plenary suit, their challenge to the district court's exercise of summary jurisdiction must fail (citations omitted).

Id., at 1037.

There are two cases dealing with the same issue which read together provide insight into the meaning of due process as it applies to receivers who seize assets in the hands of nonparties: *SEC v. Wencke*, 783 F.2d 829 (9th Cir. 1986) and, the most recent of the *Wencke* progeny, *SEC v. Ross*, 504 F.3d 1130 (9th Cir. Or. 2007). In both cases, the receiver sought disgorgement of assets, rather than the taking of assets from innocent investors. In *Wencke*, the receiver sought disgorgement of stocks and the "profits it derived from those shares." *Wencke*, 783 F.2d, at 830. The receiver's disgorgement application was served on the third party (deLusignan) in April 1981. *Id*., at 832. The district court set a hearing on the disgorgement application two and a half years later and "deLusignan filed an objection to the scheduled hearing, claiming the district court lacked personal jurisdiction over him, and that permitting the Receiver to proceed against him … would violate his due process rights." *Id*. The evidentiary hearing proceeded and

deLusignan's counsel made only a "special appearance" and "did not present evidence or question witnesses." *Id*., at 832-33.

The Ninth Circuit rejected deLusignan's claim he had been denied due process, reasoning as follows:

> Although deLusignan was deposed for a total of five days in 1977 and 1981, nothing in the record indicates that he sought any discovery on behalf of himself or Ramapo. DeLusignan and Ramapo were given the opportunity to introduce evidence and to call and cross-examine witnesses in the hearings before the magistrate and district court. Yet deLusignan's counsel merely entered a "special appearance." … DeLusignan made no objections on the merits and did not request additional time to do so.
>
> Given our decision in Universal Financial and given "all of the procedural protections" available to deLusignan and Ramapo in the district court's disgorgement proceedings, see Universal Financial, 760 F.2d at 1037, we reject deLusignan's contentions that the use of summary proceedings and the lack of a formal complaint, answer, and summonses voids the district court's disgorgement order.

Id., at 838.

In *Ross*, the Receiver also sought disgorgement from a third party (Bustos). As here, "Bustos argues that the district court violated his due process rights by exercising personal jurisdiction over him despite the failure of the Receiver to name him in the complaint." *Ross*, 504 F.3d at 1137. The Court reasoned: "Before a court may exercise the state's coercive authority over a person or property, some statute must authorize the act." *Id*., at 1138. Since the receiver had not served Bustos, there was no jurisdiction over him. Accordingly, the court and the receiver could not strip Bustos of the assets, albeit received from the defendant, without serving him. Consequently, "the district court has no power to render any judgment against the defendant's person or property unless the defendant has consented to jurisdiction or waived the lack of process. *Id*., at 1138-1139.

Significantly the third party claimants in *Wencke* and *Universal Financial, supra,* received exactly the processes Investors sought and were denied in this case. Investors sought limited discovery and an evidentiary hearing in September. The district court in *Wencke* and *Universal Financial* allowed the third party claimants in both cases both

discovery and an evidentiary hearing. Consequently, neither case has any relevance to the facts in this case.

In Re San Vicente Medical Partners, Ltd., 962 F.2d 1402 (9th Cir. 1992) lends no support to the Receiver's motion to sell the Jamul Valley property. *San Vicente* did not involve the sale of any third party assets. Rather, *San Vicente* involved a limited partnership in which the general partner was an affiliate of American Principals Holdings, Inc. (APHI), the named defendant in the SEC action. The receiver had "actively managed and completed the construction of San Vicente's office building. *Id.*, at 1404. The Ninth Circuit described the proceedings: "After a bench trial, the district court concluded that San Vicente was included in the APHI receivership and that Orr was entitled to recover a portion of his expenses from San Vicente. We affirm the judgment of the district court." *Id*.

Again, no third party claimant asserted possession, control or ownership of any asset. The court only made its decision to impose the expense on San Vicente after it conducted a *bench trial*. "San Vicente received the same notice and opportunity to be heard as it would have received as a named party to the SEC action." *Id.*, at 1408. Once again, this Court denied Investors even that hearing, despite they have far more at stake.

In *American Capital Investments, supra*, limited partners claimed they were denied due process of law by the proceedings in that case. The district court initially held it could sell the limited partnership's interests in three real estate parcels, because the general partner had the power to do so. The limited partners contended that the limited partnerships dissolved when the receivership was filed and thus the Court did not have the right to sell the property. The Ninth Circuit preliminarily found the defendant had control of the limited partnerships when the district court appointed the Receiver and thus the Receiver could acquire that possession and control:

> Here, the appointment order gave the Receiver possession and control of all assets "belonging to or in the possession or control of ACI and its . . . affiliates." The partnership assets clearly fell within the scope of this order.

> The Receiver was therefore "vested with complete jurisdiction and control of all such property . . . ." 28 U.S.C. § 754.

This process was consistent with the process discussed above in Clark, since the possession and control were in the hands of the defendant when the court appointed the receiver, assuming the investors were given sufficient participation in the proceedings, and that appears to be the case.

The court recognized the basis for its power to authorize the sale based on Clark's explanation of the court's equitable powers, which we addressed above. On this point, the Ninth Circuit quoted Clark:

> Clark also teaches that a receiver's sales do not even purport to convey "legal" title, but rather "good," equitable title enforced by an injunction against suit (citations omitted).
>
> > When a court of equity orders property in its custody to be sold, the court itself as vendor confirms the title in the purchaser. Neither the court nor [the receiver] gives a legal title to the purchaser because neither the court nor its officer has legal title to give . . . . A court of equity acts by a process of injunction against the owner and against the parties to the suit and protects the purchaser against interference and assures him a quiet title and quiet enjoyment.
>
> *Id*. at § 487. See also 3 Id. § 920 ("When a receiver of a partnership sells property he sells as the arm of the court and not as holder of the legal title").

American Capital Investments, 98 F.3d at 1144.

The court also cited *United States v. Arizona Fuels Corp.*, 739 F.2d 455 (9th Cir. Ariz. 1984) and its holdings that "plenary actions must be filed to decide the ultimate rights to property." *American Capital Investments*, 98 F.3d at 1147. The court concluded *Arizona Fuels'* holding that title issues require plenary proceedings was *dicta*, since the case did not involve the ultimate rights to property. However, and more relevant to this case, the Ninth Circuit distinguished *Arizona Fuels* on another ground: "Moreover, Arizona Fuels' exception requiring plenary proceedings applies only to third parties in possession of the property. *Id*. Again, the GPs were in possession and control of the

Jamul Valley property and thus come within the language of *American Capital Investments* quoted above.

Finally, in reaching its holding, the Court cited both SEC v. *Wencke, supra,* and *SEC v. Universal Financial, supra, as* precedents. The Ninth Circuit explained, "For the claims of nonparties to property claimed by receivers, summary proceedings satisfy due process so long as there is adequate notice and opportunity to be heard." *American Capital Investments*, 98 F.3d at 1146. It then described its holdings in *Wencke* and *Universal Financial* as cases "where investors had been afforded virtually all procedural protections which would have been available in plenary proceedings, and had notice of the nature of the proceedings, it was not improper for the district court summarily to adjudicate investors' claims to notes." *American Capital Investments*, 98 F.3d at 1147. In that context, the court implied that investors in *American Capital Investments* got the same level of due process: "In the case at bench, the summary proceedings actually afforded to appellants gave them full notice and opportunity to be heard at every critical stage. Appellants have not even attempted to show prejudice arising from the nature of the proceedings." *Id*.

In sum, *American Capital Investments* lends little if any support to the contention that this Court should approve the Receiver's proposed sale of the Jamul Valley property. To begin with, the Ninth Circuit in *American Capital Investments* found the receiver acquired possession and control of the limited partnerships directly from the defendant. No such finding has or can be made in this case. Further, like the third parties in *Wencke* and *Universal Financial*, the investors in *American Capital Investments* were able to participate in every phase of the proceedings.

And thus the investors in *American Capital Investments* were unable to show any prejudice. In this case, investors have been denied discovery (both document production and depositions) as well as an evidentiary hearing. We have articulated in the motion for intervention ten different procedures investors have been denied which severely prejudices their claim. Dkt. No. 1274, at 10-15.

IV. The GPs as Co-Tenant Owners of the Jamul Valley Property and those GPs' Partners Are Necessary Parties in This Case

There have always been two levels of necessary parties in this case. First, the Court proposes to sell the Jamul Valley property, which is owned by three GPs: Hidden Hills Partners, Jamul Meadows Partners and Lyons Valley Partners. On the basis of the authorities discussed above, these three GPs are necessary parties in this case. Further, also as discussed above, the Receiver—the person who was violating the GPs' due process rights—controls them. Consequently, they could bring no motion to intervene or otherwise take any other action to defend against the Receiver's violation of their due process rights.

Further, the Receiver intends to effectively dissolve the GPs and distribute the proceeds of the real property sales to third parties who are strangers to the GPs' partnership agreements. For these reasons, among others, investors were and are necessary parties to this case. Investors refer to the following cases: *Delta Fin. Corp. v Paul D. Comanduras & Associates*, 973 F.2d 301 (4th Cir. 1992); *Rudnick v. Delfino*, 140 Cal. App. 2d 260 (Cal. App. 1956); *Valley Nat. Bank of Arizona v. A.E. Rouse & Co.*, 121 F.3d 1332, 1336 (9th Cir. 1997); *Nisenzon v. Sadowski*, 689 A.2d 1037, 1048 (R.I. 1997); *Duncan, Inc. v. Head*, 519 So.2d 1305, 1308 (Ala. 1988); *Foster Lumber Company, Inc. v. Glad*, 303 N.W.2d 815, 816 (S.D. 1981); *Detrio v. United States*, 264 F.2d 658, 660 (5th Cir. 1959); and *Teitelbaum v. Wagner*, 2003 U.S. Dist. LEXIS 2481, 7-8 (SDNY 2003). See also Clark, § 397 at 685; § 532(b) at 848; and § 636 at 1049.

V. The Due Process Permitted to the GPs and Investors Was Too Little Too Late

In this case, a temporary receiver was appointed without notice to investors or the GPs. Twenty-two months after the Receiver was appointed, the Court set a hearing for the GPs to seek release from the receivership. Dkt. No. 629 at 7. The GPs remained under the control of the Receiver. *Id*., at 8. The order did not permit the GPs access to the GPs' records, including investor contact information. The order did not permit the GPs to argue whether the Court had jurisdiction to appoint the Receiver. Rather, the order narrowed the issue the GPs could address to the following: "The Court sets a hearing on

October 10, 2014, at 1:30 p.m., at which time the GPs will be permitted to respond to the Court's decision to *keep* the GPs in the receivership (emphasis added)." *Id*.

As for investors, the order was even narrower. It did not give them any independent right to speak at the hearing. The order defined the permissible scope of investors' comments as follows:

> If an individual investor within a particular GP disagrees with his or her GP's official response to the Court's decision, the individual's points of disagreement shall be included in a separate section of his or her GP's official response. In this situation, a GP's brief may not exceed twenty (20) pages.

Dkt. No. 629 at 8. Investors were not permitted to question the Court's jurisdiction for appointing the Receiver: either subject matter jurisdiction or personal jurisdiction over investors or the GPs. Nor were investors permitted to question whether they were bound by any of the Court's prior orders.

On the question of notice, paragraph 11 of the order read as follows: "The Receiver is directed to disseminate this Order by: (1) posting it on the website designated for this litigation, (2) emailing it to individual investors, and (3) mailing it to the address of record for each GP." Dkt. No. 629 at 9. The order obviously did not provide for personal service on investors. As for service over the Receiver's website, investors know of no case which has authorized this form of service for personal service. Further, the Receiver has acknowledged: "Unfortunately, most investors in this case have not reviewed the reports and other important information about their GPs posted on the receivership website." Dkt. No. 852, at 2, 12-13. With respect to the Receiver's service of the order by email, we again know of no authority which allows this as a substitute for personal service. It is unknown to what extent the Receiver had current email addresses for investors. Further, in view of the investors' perception of the Receiver,[2] many may not have even opened the email. And of course, the Receiver's service of the order on the GPs means he served the notice on himself. In this regard, we note the receiver has filed

[2] See results of Investors' survey in Declaration of David Karp, Dkt. No. 1293-3.

no declaration with the court stating the manner in which he served either the GPs or investors. Accordingly, this service clearly was defective for the same reasons the service in *SEC v. Ross, supra*, was defective.

The order provided the Receiver should give notice, but no declaration relating to that notice has ever been filed with the Court. Consequently, it is unknown to what extent investors were informed of this hearing. The Court did not direct the Receiver to provide any funds for the GPs to retain independent counsel. Nor did the order allow investors to conduct any discovery. The Court held hearings pursuant to the order on October 10 and 15, 2014, and on January 23, 2015, but GPs were only allowed to speak on the hearings on October 10 and 15, 2014. Only investors in a small fraction of the GPs were able to organize an appearance. At the hearing, the GPs were limited to a 15-minute presentation. No cross examination was permitted. No counsel appeared on behalf of investors. Neither the GPs nor investors had subpoena power. Again, this is not the level of due process contemplated by *Wencke*, *Universal Financial*, *American Capital Investments* or *Ross*.

The Court had already decided numerous issues in this case prior to the October 10, 2014, hearing. It had issued more than 40 orders. This limited hearing does not meet the standards recognized by Clark and the Ninth Circuit decisions discussed above. Clark speaks directly to the issue of the appointment of a receiver without notice to interested parties:

> The Fourteenth Amendment of the Constitution of the United States prohibits the taking of property without due process of law. The appointment of a receiver of the property of an individual or of a corporation which goes so far as to divest the corporation of the title of the property and vests the title in the receiver, without an opportunity to be heard on the application, is the making by the court before final hearing of what amounts to a final order in the case, adjudicates a substantive right, and is in conflict with the Constitution of the United States and, therefore, a void order.

Clark, § 82(c) at 127.

In the event the court appoints a receiver without notice, a hearing must be set early that allows all interested parties to raise all relevant issues relating to the appointment of the receiver. On this point, Clark reads:

> An order made ex parte or without notice appointing a receiver should set an early time and provide that the party injuriously affected may come into court and move to set aside, vacate or modify the order. Unless we have such a provision in the order of appointment and/or unless the court does entertain such a motion, then we have the situation wherein the court is taking control and possession of property of a person or corporation without giving that person or corporation an opportunity to have his day in court and resist such order of the court. We believe failure to give the party injuriously affected an opportunity ultimately to be heard, violates the United States Constitutional provisions providing for due process of law.

Id., § 82(i), at 129. Investors submit, for the reasons stated in Clark, their rights under the U.S. Constitution to due process of law were violated.

VI. If the Court Approves the Sale of the Jamul Valley Property, It Should Segregate the Proceeds

In the event the Court approves the sale of the Jamul Valley property, it should segregate the proceeds of the sale until the Ninth Circuit decides Investors' appeal. A similar issue arose in *American Capital Investments*, but only during oral argument before the Ninth Circuit, and thus the Court chose not to consider it. The Ninth Circuit noted: "At oral argument, the Investors for the first time raised the possibility of imposing a constructive trust on the proceeds from the sale of property included in the JH sale, rather than voiding its conveyance. Because this theory was not briefed, we decline to consider it." *American Capital Investments*, 98 F.3d at 1141.

If the Court distributed the proceeds pro rata as the Receiver proposes, the Court would effectively be making a decision to reclassify the character of these assets. The Court has held that case law does not require pervasive fraud or commingling to pool all assets and redistribute them in conflict with the partnership agreements. Investors in each GP would be stripped of their partnership rights to a distribution of those assets. In effect, the Court would void the partnership agreements and create new ones under its equitable

powers. We know of no case that has gone this far and no party has cited one. Accordingly, Investors propose the Court segregate any proceeds from the sale of the Jamul property pending the decision of the Ninth Circuit. This remedy is frequently used in federal receivership cases. See: *SEC v. Capital Cove Bancorp LLC*, 2015 U.S. Dist. LEXIS 174859 (C.D. Cal. Oct. 13, 2015)("All sale proceeds shall be held in segregated accounts maintained by the Receiver pending further order of the Court or written agreement among all parties asserting a claim to the funds in a particular account."); *SEC v. Capital Cove Bancorp LLC*, 2015 U.S. Dist. LEXIS 174856, 26-27 (C.D. Cal. Oct. 13, 2015)("To promote the equitable distribution of Defendants' assets, and given the *bona fide* dispute at issue here, the Court approves the Receiver's request to hold sale proceeds in segregated accounts in lieu of immediate distribution.")

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Respectfully submitted,

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