Gary J. Aguirre (SBN 38927)
Aguirre Law, APC
501 W. Broadway, Ste. 800
San Diego, CA 92101
Tel: 619-400-4960
Fax: 619-501-7072
Email: Gary@aguirrelawfirm.com

Attorney for Investors Susan Graham *et al*.

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 SECURITIES AND EXCHANGE COMMISSION'S LATE JOINDER IN RECEIVER'S MOTION FOR: (A) AUTHORITY TO CONDUCT ORDERLY SALE OF GENERAL PARTNERSHIP PROPERTIES; (B) APPROVAL OF PLAN OF DISTRIBUTING RECEIVERSHIP ASSETS; AND (C) APPROVAL OF PROCEDURES FOR THE ADMINISTRATION OF INVESTOR CLAIMS

Date: May 6, 2016
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

I. Introduction

Investors[1] file this opposition to a brief filed by the Securities and Exchange Commission ("SEC") on April 15, 2016. Dkt. No. 1232. In form, the SEC called its brief ("Brief") a "response" to the Receiver's Notice of Motion and Motion for (A) Authority to Conduct Orderly Sale of General Partnership Properties; (B) Approval of Plan of Distributing Receivership Assets; and(C) Approval of Procedures for the Administration of Investor Claims ("Liquidation Motion") filed on February 4, 2016 (Dkt. No. 1181). In substance, the SEC Brief was a later joinder with points and authorities supplementing the Receiver's Liquidation Motion. The SEC could have filed its motion at any time within the 28 days of the motion date. Instead, the SEC filed its brief on the deadline for the filing of the Investors' opposition to the Receiver's Liquidation Motion, thereby assuring Investors would have no chance to respond. Further, the Receiver's Liquidation Motion never mentioned the word "commingling" in his brief. It was the primary focus of the SEC Brief. Because of other demands in this case, this is the earliest Investors are able to file this opposition.

We address each of the SEC's express and implied contentions, which center on the issue of "commingling." The Court made no finding or holding that commingling took place. We urge the Court to deny the SEC's and Receiver's motion. Even if the Court had made a decision, and it has not, that decision would not be binding under the principles of issue preclusion, since Investors were not parties to this case. *Wige v. City of L.A.*, 713 F.3d 1183, 1185 (9th Cir. Cal. 2013)("the party against whom issue preclusion is asserted must have been a party to the earlier action or in privity with such a party"). It would, however, be binding on the SEC had the Court addressed the issue. As discussed below, we believe the issue was twice resolved against the SEC and thus it cannot raise it again.

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

II. The "Intertwining" between Western and the GPs Creates No Obstacle to Releasing the GPs from the Receivership

The SEC argues against allowing Investors to decide what they wish to do with their investments. It argues, "the reasons for keeping the general partnerships in the receivership are just as compelling, if not more so, now, during an orderly sale of assets, as they were back in March 2015 when the Court issued that ruling." Dkt. No. 1232 at 2, 5-8. Not only is this inaccurate, but the reverse is true. The Court's March 4, 2015, order (Dkt. No. 1003) described a simple process for severing the relationship between Western and the GPs: "the Court could order Western to divest its interest and the GPs to pay the notes." Dkt. No. 1003, at 20, 11-12.

The Court decided this step was premature in March 2015, because "Western may not be liable for disgorgement or fraud and altering the structure of the GPs at this stage may be prejudging Western's liability." *Id*, 13-14. Since then, the Court has granted a summary judgment against Western for disgorgement for approximately $137 million plus interest.[2] Dkt. No. 1074. Consequently, the precondition for divesting Western from the GPs, its liability for disgorgement, has occurred. Hence, the time is now ripe for the Court to order "Western to divest its interests and the GPs to pay the notes." Obviously, some cash adjustments would have to be made between the GPs and Western, but those adjustments cannot be done until the Receiver provides an accounting.

III. The SEC's Support for the "One-Pot Approach" Dissolving GPs Requires the Partners Be Joined as Necessary Parties

The SEC describes the investment vehicle owned by investors 17 times in its brief: they are partners in general partnerships. The SEC proved the GPs are securities, but no party has disputed the enforceability of the GP agreements. However, in arguing for pooling, the SEC proposes each of the 87 valid agreements be dissolved and 99 percent of the assets be distributed to persons who have no rights under the agreement.

[2] For reasons we cannot ascertain from the file, the Court issued a final judgment against Louis Schooler, but not Western.

Like the Receiver, the SEC does not address the state and federal decisions which hold that partners in general partnerships are necessary parties. *Delta Financial Corp. v. Paul D. Comanduras & Assoc.*, 973 F.2d 301, 306 (4th Cir. Va. 1992); *Rudnick v. Delfino*, 140 Cal. App. 2d 260, 265 (1956). We made this allegation in the complaint (Dkt. No. 1229-1, ¶¶ 12, 13(A) and 14(A)) and argued it in three prior filings: Dkt. Nos. 1206 at 8, 1235 at 16, and 1274 at 4-5. The SEC has yet to counter those arguments or even respond.

Nor has the Court addressed the issue. The Court did cite *In re San Vicente Med. Partners Ltd*., 962 F.2d 1402, 1408 (9th Cir. 1992) for the principle that "the Ninth Circuit has made it clear that the Court has authority to place a nonparty's property under a receivership even where the nonparty is not accused of any wrongdoing." Dkt. No. 1003 at 5, 17-19. That principle applies where the GP is treated as a single entity, but not where the proceeding would liquidate the GP. *Mathews v. Traverse (In re Pappas)*, 1994 U.S. App. LEXIS 8881 (9th Cir. Cal. Apr. 13, 1994)("Under California law, 'ordinarily all partners are not only proper, but are also necessary, parties to an action for dissolution (citations omitted)'"). See also: *Pacific Queen Fisheries v. Symes*, 307 F.2d 700 (9th Cir. Wash. 1962)("Was the district court correct in holding appellants Hull, Peck and Royer to be partners in Pacific Queen Fisheries, and necessary parties whose admissions would be binding on appellant Pacific Queen?"); *SEC v. American Capital Invs*., 98 F.3d 1133, 1145 footnote 17 (9th Cir. Cal. 1996)("[B]oth types of receivers [state and federal] 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*. See 2 Clark on Receivers §§ 482, 491 (emphasis added)."

This case became a proceeding to dissolve the 87 GPs on February 4, 2016, when the Receiver filed his proposed liquidation plan (Dkt. No. 1181) and thus, from that moment forward, the partners in the 87 GPs became necessary parties. The Receiver has

taken no steps to join or serve them. Instead, to the best of our knowledge, he has not even given the partners notice of his plan to liquidate the GPs.

This does not mean that 3,500 parties would appear in this case. The Receiver has options. He can withdraw his plan. Alternatively, the Receiver could file a defendant class action and serve the class by mail. *National Asso. for Mental Health, Inc. v. Califano*, 717 F.2d 1451, 1457 (D.C. Cir. 1983)("Defendant class actions are clearly authorized by Rule 23 of the Federal Rules of Civil Procedure.") A defendant class action was recently filed as an adversary proceeding by a trustee (recommended by the SEC) against approximately 3,000 investors in a Chapter 11 Proceeding, *In re Life Partners Holdings Inc. et al*, , Case No. 15-40289-rfn-11, which arose out of *SEC v. LPHI*, a bankruptcy case.[3]

IV. The SEC Cites No Authority for Pooling in the Absence of Pervasive Fraud or Pervasive Commingling

The SEC invites the Court to take pooling to a new frontier where no other court has ventured. But it points to no legal principle needed for the journey. It cites numerous cases for sweeping generalities ("equity demands equal treatment of victims in a factually similar case," Dkt. No. 1232 at 2, 16-17) and a few cases where it snatched a phrase or two out of context. But it has cited no case where any court has (1) approved a distribution plan in the absence of pervasive fraud or pervasive commingling or (2) articulated a principle of law that supports pooling in this case.

To support its theory, the SEC must reach far: all the way to Regulation D. The SEC argues: "The commingling of funds and intertwining of investor interests here were extensive and well established. The Court has already found that 'Western's sales of GP units for all the GPs [was] a single, integrated offering.' Dkt. No. 1074 at 8." Dkt. No.

[3] See http://dm.epiq11.com/LFP/Docket#Debtors=5890&RelatedDocketId=&ds=true&maxPerPage=150&page=1. The case filings in this proceeding, *Moran v. Alexander et al*., were last checked May 2, 2016.

1232 at 5, 9-11. The "integrated offering language" is one of the factors articulated in 17 CFR 230.502 for determining whether sales should be integrated in relation to a Regulation D exemption. We can find no case or SEC release which has ever linked any 17 CFR 230.502 factor to the issue whether investors' funds were commingled.

We address below only the three cases which the SEC claims offer some specific guidance. The SEC's favorite case is *SEC v. Sunwest Mgmt*., 2009 U.S. Dist. LEXIS 93181 (D. Or. Oct. 2, 2009). The case based its pooling decision on both "massive fraud" (*Id*, at 20) and "extensive and pervasive" commingling. *Id*. at 31. This Court made neither finding in this case. The SEC's citation of *Sunwest* eight times underscores our point. It cannot find a case to challenge a simple contention: the courts do not order pooling without pervasive commingling or pervasive fraud. See *SEC v. Founding Partners Capital Mgmt*., 2014 U.S. Dist. LEXIS 90864 (M.D. Fla. July 3, 2014) and *See Amerifirst Funding*, 2008 U.S. Dist. LEXIS 20044, 2008 WL 919546 at *4.

The SEC also argues that *CFTC v. Eustace*, 2008 U.S. Dist. LEXIS 11810 (E.D. Pa. 2008) allowed pooling with a lower requirement for commingling. This is true. The *Eustace* court focused on the fraud: "This case involves a massive fraud in commodity futures trading." On commingling, the court observed, "Eustace's commingling was not necessarily systematic, but the instances of commingling indeed reflect Eustace's blurring of the distinction between the Receivership Funds." *Id*. 22 Finally, like in *Eustace* and *Sunwest*, the Court in *Quilling v. Trade Partners, Inc.*, 572 F.3d 293, 300 (6th Cir. Mich. 2009) found both commingling and fraud.

The SEC utterly confuses the concept of tracing. In the cases cited by the SEC, an investor whose funds were commingled makes this argument: "Our funds may have been commingled, but we can trace the funds back to us." On this point, the SEC again cites its favorite case, *SEC v. Sunwest Mgmt.*, 2009 U.S. Dist. LEXIS 93181, 34 (D. Or. Oct. 1, 2009)("Typically, tracing of invested funds does not yield the most equitable result, because the ability to trace funds is the result of the merely fortuitous fact that

certain investor funds were spent before funds of others, where the funds of investors have been shown to be substantially commingled.")

Investors do not argue tracing. Their funds were never commingled. Tracing is a last resort, like a life preserver. One needs no life preserver unless water is near. Investors' funds were never pooled. The Court never made such a finding. There was not a sliver of evidence supporting the theory. Rather, the SEC set up a straw man and then knocked him down.

V. The Court Found No Pervasive Fraud or Any Commingling

The Court did not find, conclude, or hold Western had engaged in any conduct that would warrant pooling in this case. The Court made one finding of fraud in relation to one property based on one misrepresentation.[4] That finding affected 4 of 87 GPs and thus by definition does not constitute a "unified fraud" that stretched "across the receivership entities." See *SEC v. Founding Partners Capital Mgmt*., 2014 U.S. Dist. LEXIS 90864 (M.D. Fla. July 3, 2014) and *See Amerifirst Funding*, 2008 U.S. Dist. LEXIS 20044, 2008 WL 919546 at *4.

Nor has Court has found any commingling. It appears the issue arose twice before the Court. When defendants moved to modify the preliminary injunction, they explicitly argued no evidence of commingling was before the Court. Dkt. No. 195 at 7, 1. The SEC did not challenge this contention in its brief. Dkt. No. 207. Nor did the Receiver. Dkt. No. 206. In its August 16, 2013, order (Dkt. No. 470), the Court noted that defendants had argued "neither the SEC nor the Receiver have identified any evidence of misappropriation of funds, commingling, or other financial mismanagement." *Id*, at 5, 2-3. The SEC offered no evidence and made no counterargument. The Court made no express or implied finding that any investors' or GP's assets had been commingled. Had

[4] *SEC v. Schooler*, 2015 U.S. Dist. LEXIS 71956 at 20 (S.D. Cal. June 3, 2015)(that, "under current market conditions," the South Stead property would "be evaluated at approximately $2.50 per sq foot,"—was a material misrepresentation.)

the Court's August 16 order become final, the SEC would have been precluded from raising the issue again. *Wige v. City of L.A.*, 713 F.3d at 1185.

The Court later *sua sponte* reconsidered its August 16 order (Dkt. No. 629). The parties again briefed the issues. The SEC made a stunning new argument: a party can commingle its own funds. Specifically, the SEC argues that Western "commingles" funds when it deposited in its own bank account the funds it received from the sale of a property to a GP. Until now, this practice had never been called commingling. It has been called a sale. Investors predict plaintiff's attorneys would widely embrace the new concept. Under this theory, every brokerage firm that sells a security engages in this form of commingling when it transfers the purchase money to its own account. The SEC abandoned this argument when defendants' counsel argued that every auto sale would also include this new species of commingling.[5] The Court made no finding of any commingling in its March 4 order (Dkt. No. 1003) as that term is used to describe the situation where investors' funds lose their separate identity when they are placed in a stock promoter's personal account. Rather, the Court explained it had used the term in the sense of being "intertwined," i.e., both investors and Western held interests in the same GPs. The SEC should be precluded from again asserting its bizarre definition of commingling.

In referring to the other meaning of "commingling" (not intertwining), the Court cited 34 C.F.R. § 303.123. That regulation defines commingling as follows: "As used in this part, commingle means depositing or recording funds in a general account without the ability to identify each specific source of funds for any expenditure." This comes very close to the operative definition the courts have applied in SEC cases. We have italicized the key language in the cases quoted below on commingling: *SEC v. Sterns*, 1991 U.S. Dist. LEXIS 13968 (C.D. Cal. Aug. 22, 1991) ("All of the money raised through the sale of the above-mentioned securities was *commingled and deposited into*

[5] Jan. 23, 2015, Reporter's Transcript of Receivership Hearing at 8, 18-22.

Fountain Industries' checking accounts, after which the proceeds were ... to bankroll the personal spending habits of those involved … and other members of their family."); *SEC v. Shaoulian*, 2003 U.S. Dist. LEXIS 16279, 15 (C.D. Cal. Apr. 14, 2003)(**"**Almost all of the trading profits were *commingled in the business and personal bank accounts* of Samuel Shaoulian."); *SEC v. Geotek*, 1978 U.S. Dist. LEXIS 16370 (N.D. Cal. July 25, 1978)("[S]he failed to disclose that Fundamental would hold title to properties of the newly created companies and that their funds would be *commingled in Fundamental bank accounts*;"); *SEC v. Trabulse*, 526 F. Supp. 2d 1008 (N.D. Cal. 2007)("He commingled funds,... The SEC provides examples. On October 4, 2004, and on August 15, 2005, Trabulse transferred approximately $ 20,000 *to his wife's overseas bank account*… The money, however, was actually transferred so his wife could go shopping in France while they vacationed there."); *SEC v. Los Angeles Trust Deed & Mortg. Exchange*, 186 F. Supp. 830 (S.D. Cal. 1960)("These funds are placed in the separate account and are not commingled with the company's …").

This remarkable new concept that Western could commingle its own assets never occurred to the Receiver. He looked for the old fashion type of commingling, the one the SEC recognized during its first 81 years. And he looked hard for eight months. He never cited, referred to, found, much less introduced any evidence of commingling. If anyone had a chance to find it, the Receiver did. None of his 14 interim reports even hinted of commingling mush less finding any of it.

He also conducted forensic studies of the GPs and Western for eight months. He knew when he began his forensic investigation in February 2013 that each GP and Western had separate bank accounts and books and records. Dkt. No. 182. Consequently, he looked deeper for conflicts: inconsistencies between the bank accounts and the books and records, which would suggest commingling. In his third interim report (DKt. No. 80) in February 2013 he discussed the "forensic accounting and analysis of the Receivership Entities" that had already launched:

> The Receiver has commenced his forensic accounting and analysis of the Receivership Entities. This project includes verifying the reliability of the books and records of the Receivership Entities by reconciling them to bank statements and other supporting documentation, documenting the amount of funds raised through the GPs and analyzing how the funds were used, summarizing and reviewing the propriety of disbursements, and summarizing fees and amounts otherwise retained by Defendants. When his forensic accounting work is completed, the Receiver expects to be able to report on:
>
> - How much money was raised from investors;
> - How much money raised from investors was transferred to Defendants;
> - How much of the money raised from investors remains in the GPs; and
> - How investor money transferred to Defendants was used.

Dkt. No. 80 at 8, 5-16. He completed his forensic and accounting report eight months later. Neither forensic report mentioned commingling or hinted at its existence. Dkt. Nos. 182 and 504. They conclusively establish the absence of any old fashioned commingling.

When the Receiver did his forensic analysis of the GPs and Western accounting systems to find commingled or misappropriated funds, he performed numerous "testing procedures to ensure the accuracy and reliability of the OPADS Accounting System and other data maintained by Western." Dkt. No. 182 at 14, 7-9. Based on that testing, the Receiver concluded: "At the conclusion of these tests, the Receiver determined that the data maintained in the OPADS Accounting System and the other data sources noted above is accurate and reliable, and therefore could be used in performing the forensic accounting." Dkt. No. 182 at 15, 14-17.

And then there is the meat of both reports: 250 pages of reports. Dkt. Nos. 182 and 504. We can find no statement by the Receiver where he found an inconsistency between the accounting system and the bank accounts. They reconcile. And once again, the SEC's argument tells more about their approach to this case than about the evidence in this case.

VI. Investors Contend above They Became Necessary Parties When the Receiver Filed His Liquidation Plan

To the extent there is any question in the Court's mind, Investors seek a trial on this issue before a jury. The SEC's loose arguments should not be elevated to the equivalent of a judgment binding on investors.

Dated: May 3, 2016

Respectfully submitted,

By: /s/ Gary J. Aguirre
GARY J. AGUIRRE
Attorney for Investors

Gary J. Aguirre (SBN 38927)
Aguirre Law, APC
501 W. Broadway, Ste. 800
San Diego, CA 92101
Tel: 619-400-4960
Fax: 619-501-7072
Email: Gary@aguirrelawfirm.com

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UNITED STATES DISTRICT COURT

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

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LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING CORPORATION d/b/a WESTERN FINANCIAL PLANNING CORPORATION,

Defendants.

Case No.: 3:12-cv-02164-GPC-JMA

EX PARTE MOTION FOR LEAVE TO FILE INVESTORS' OPPOSITION TO SECURITIES AND EXCHANGE COMMISSION'S LATE JOINDER IN RECEIVER'S MOTION FOR: (A) AUTHORITY TO CONDUCT ORDERLY SALE OF GENERAL PARTNERSHIP PROPERTIES; (B) APPROVAL OF PLAN OF DISTRIBUTING RECEIVERSHIP ASSETS; AND (C) APPROVAL OF PROCEDURES FOR THE ADMINISTRATION OF INVESTOR CLAIMS OR IN THE ALTERNATIVE TO STRIKE THE SEC'S BRIEF

Date: May 6, 2016
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

Investors[1] move this court for leave to file opposition to the Securities and Exchange Commission brief ("Brief") filed on April 15, 2016, (Dkt. No. 1232) as a "in response" to the Receiver's Motion for (A) Authority to Conduct Orderly Sale of General Partnership Properties; (B) Approval of Plan of Distributing Receivership Assets; and (C) Approval of Procedures for the Administration of Investor Claims (Dkt. No. 1181) ("Liquidation Motion")

By its order of April 5, 2016, (Dkt. No. 1224) the Court authorized the filing of any "opposition" by April 15, 2016, to the Receiver's Liquidation Motion. The SEC Brief did not oppose any contention by the Receiver in its Liquidation Motion. Rather, the SEC's Brief stated: "In short, the SEC fully supports the receiver's proposal for the orderly sale of receivership assets." Dkt. No. 1232 at 2, 9-10. Accordingly, the SEC Brief was not authorized as "opposition" to the Receiver's Liquidation Motion by the Court's April 5, 2016, order.

The SEC's Brief in substance was a joinder in the Receiver's Liquidation Motion with additional arguments and points and authorities filling in gaps in the Receiver's Liquidation Motion. As such, it should have been filed at least 28 days before the hearing date pursuant to Local Rule 7.1(e)(1). By filing its Brief on April 15, 2016, at 4:49 p.m., with Investors' opposition brief due that day, the SEC timed its Brief to prevent Investors from filing any opposition to it under the local rules. Further, the Receiver stated in his Liquidation Motion that the SEC had approved its Liquidation Motion before he filed it.

Due to the filing deadlines in this case, for other briefs, Investors were unable to file this motion until now.

WHEREFORE, Investors respectfully request this Court to grant this motion allowing them to file the attached brief or, in the alternative, to strike the SEC's Brief (Dkt. No. 1232) as a late filing under the local rules.

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

Dated: May 3, 2016

Respectfully submitted,

By: /s/ Gary J. Aguirre
GARY J. AGUIRRE
Attorney for Investors