SAM S. PUATHASNANON, Cal. Bar No. 198430
Email: puathasnanons@sec.gov
LYNN M. DEAN, Cal Bar. No. 205562
Email: deanl@sec.gov
SARA D. KALIN, Cal. Bar No. 212156
Email: kalins@sec.gov

Attorneys for Plaintiff
Securities and Exchange Commission
Michele Wein Layne, Regional Director
Lorraine Echavarria, Associate Regional Director
John W. Berry, Regional Trial Counsel
444 S. Flower Street, Suite 900
Los Angeles, California 90071
Telephone: (323) 965-3998
Facsimile: (213) 443-1904

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

vs.

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

Defendants.

Case No. 12 CV 2164 GPC JMA

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S RESPONSE TO RECEIVER'S REPORT AND RECOMMENDATIONS REGARDING GENERAL PARTNERSHIPS

Date: January 23, 2015
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

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I. INTRODUCTION

After extensive briefing and hearings on the matter, the Court asked that its appointed receiver issue a report and recommendation to help the Court resolve whether the general partnerships ("GPs") should remain in the receivership. Plaintiff Securities and Exchange Commission ("SEC") files this response, at the Court's instruction, to the report and recommendation filed by the receiver (Dkt. No. 808).

In the SEC's respectful opinion, the most important statement by the receiver in his report is the following, which recognizes the inherent difficulties and unfairness that would result for the release of the GPs:

> Releasing receivership assets before deciding whether investors were defrauded is premature, extremely difficult to accomplish in a way that is fair and equitable to all investors, and unnecessarily limits, the recovery of investors who are released.

The SEC could not agree more. Keeping the GPs in the receivership would ensure that all of the investors are treated equally and would preserve the option to make a *pro rata* distribution for the benefit of all investors. Moreover, with its broad equitable authority, the Court can and should exercise jurisdiction over, and include in a receivership, all of the property previously in the defendants' possession or control, even if that property is nominally owned by non-parties to the action. This would necessarily include the GPs. Indeed, once the Court found that the GP interests are securities, it necessarily followed that the investors depended on the defendants for a return on their investment. For that reason, the Court *sua sponte* decided to reconsider, and then in July 2014 ultimately reversed, its previous August 16, 2013 order removing the GPs from the receivership. *See* Dkt. No. 629.

Given defendants' management and control over the GPs, inclusion of the GPs in the receivership is appropriate and warranted. Because the Court later held in July 2014 that the GPs should remain in the receivership, the Court should take the next logical step and vacate its previous August 2013 order. It should also formally deny the defendants' March 2013 motion that sought to remove the GPs in the first place,

to the extent it is reconsidering that motion now. To do so would be entirely consistent with the Court's prior orders. Indeed, all of the arguments made by defendants in support of that old motion have either been mooted, proven wrong or rejected by the Court. Formally denying that motion and vacating the August 2013 order would also conserve judicial resources since the parties have pending cross-appeals before the Ninth Circuit regarding that ruling.

As for the rest of the receiver's report and recommendation regarding the GPs, the SEC submits that the two proposals made by the receiver are flawed because they treat similarly situated investors disparately. As part of his proposals, the receiver would have certain GPs released, which would necessarily remove from the receivership estate some of the move valuable real property in the estate. Also, if this were done, investors in the released GPs would be prohibited from participating in any future distribution from the receivership estate. Moreover, under either proposal, it is likely that some GPs would be released while others would remain. Such a result would lead to different treatment of and different returns for the investors in GPs that remained as compared to the investors in GPs that were released.

Therefore, the SEC respectfully asks the Court to heed its receiver's warnings about the inequities of releasing the GPs at this stage of the case, and to adhere to its previous July 2014 ruling that the GPs should remain in the receivership.

II. FACTUAL BACKGROUND

A. Appointment Of The Receiver

Since the beginning of this action, a receiver has been appointed and in place over Western Financial Planning Corp. ("Western") and the GPs. The Court, upon the SEC's application, temporarily appointed the receiver, Thomas Hebrank, in September 2012. *See* Dkt. No. 10. On October 5, 2012, and following briefing by both parties, the Court issued a preliminary injunction, finding that the SEC had made a *prima facie* case that the GP units were securities in the form of investment contracts and that defendants had violated the registration provisions of the securities

laws. *See* Dkt. No. 44 at 3-4, 22, 24. The Court also permanently appointed Mr. Hebrank as the receiver over Western and the GPs. *See* Dkt. Nos. 59, 174.

B. The Court's August 2013 Order Removing The Receiver Over The GPs And The Parties' Cross-Appeals

Five months later, on March 13, 2013—long after the time to appeal from the preliminary injunction had expired—defendants filed a motion to modify the preliminary injunction and remove the GPs from the receivership. *See* Dkt. No. 195. In support of its motion, defendants made five arguments, all of which have since been rendered moot, proven incorrect, or rejected by the Court: (1) Western did not control the GPs, (2) the GPs were entitled a pre-receivership hearing, (3) a receiver was not necessary to manage raw land, (4) the receiver had endorsed the integrity of the accounting records for both Western and the GPs, and (5) the receiver was seeking to liquidate the GP properties. *See* Dkt. No. 195-1 at 12-22. On August 16, 2013, the Court determined that the GPs should be released from the receivership upon the satisfaction of certain conditions ("August 2013 Order"). *See* Dkt No. 470. Those conditions were never satisfied and the GPs were never released because defendants elected to appeal the Court's August 2013 Order. *See* No. 13-56761 (9th Cir.). In that appeal the defendants objected to one of the conditions imposed in the Court's August 2013 Order. The SEC cross-appealed, objecting to the release of the GPs from the receivership. *See* No. 13-56948 (9th Cir.). Briefing in these appeals was completed on March 13, 2014.

C. The Court's Order Finding That The GP Units Are "Securities" And Its Reconsideration Of Its August 2013 Order

Meanwhile, the parties filed competing summary judgment motions on the crucial issue of whether the GP units are securities. The Court's ruling on those motions resulted in its reconsideration of its August 2013 Order releasing the GPs from the receivership. On April 25, 2014, the Court granted, in part, the SEC's motion for partial summary judgment, finding that the GP units are securities under at

least the first *Williamson* factor ("April 2014 MSJ Order"). *See* Dkt. No. 583 at 20. In light of this finding, the Court also found good cause to reconsider, *sua sponte*, its August 2013 Order to release the GPs. *See id.* Then, on June 19, 2014, Ninth Circuit decided to hold the parties' pending cross-appeals in abeyance until this Court issued its order on its reconsideration of the August 2013 Order. *See* Nos. 13-56761, 13-56948 (9th Cir. June 19, 2014). The Ninth Circuit's order also remanded the case to this Court for the limited purpose of reconsidering the August 2013. *See id.*

On reconsideration, this Court correctly concluded on July 22, 2014 that the GPs should continue in the receivership ("July 2014 Reconsideration Order"). *See* Dkt. No. 629. In its ruling, the Court determined that maintaining 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." *Id.* at 7-8.

But before vacating the portion of the August 2013 Order, the Court found it appropriate to give the GPs an opportunity to file briefs and be heard, and scheduled a hearing for October 10, 2014.[1] The Court permitted each GP to file a single brief in response to the Court's decision to keep the GP's in the receivership. *See id*. at 8. In all, about 57 GPs filed responses or notices on their own behalf (17 of which filed more than one response) and only seven GPs filed a notice to appear. The vast majority of the GP responses make substantially similar, if not, the same arguments.

At the October 10, 2014 hearing, the Court further continued the hearing to October 15, 2014, so that the parties would have a chance present their positions to the Court and respond to the investors.

[1] As explained in the SEC's brief filed in response to the Court's April 2014 MSJ Order, due process did *not* require this hearing. Dkt. No. 588 at3, n.2; *see also San Vicente*, 962 F.2d at 1407 (clarifying that a pre-receivership hearing is not required before non-party entities controlled by the defendant are included in receivership so long as *at a later time*, before any material deprivation of property interest occurs).

D. The Receiver's Recommendations

After that hearing, on October 17, 2014, the Court entered an order stating that it needed more information to resolve the issue of whether the GPs should remain in or be released from the Court-ordered receivership. *See* Dkt. No. 808 at 1. Among other things, the Court asked the receiver to prepare an updated report and recommendations that included for each GP specific financial information enumerated in the order, such as the amount of cash on hand and the amount owed by the GP to Western and the associated payment schedule. *See id.* at 3-4. The Court also ordered the receiver, based on his analysis of the financial state of each GP, to assess whether it is prudent to release or maintain the receivership in relation to each GP. *See id.* The Court also permitted further briefing by the parties and allowed more input from individual investors, and set a hearing for December 17, 2014. The Court later granted the receiver's application to continue the hearing date to January 23, 2015. *See* Dkt. No. 831.

In its report and recommendation, the receiver outlined for the Court the "key factors" and "legal principles" relevant to its report. In his discussion of the investors claims, one of the key factors, the receiver warned about the difficulties and inequities that would result from releasing the GPs from the receivership state early in the case:

> Releasing receivership assets before deciding whether investors were defrauded is premature, extremely difficult to accomplish in a way that is fair and equitable to all investors, and unnecessarily limits, the recovery of investors who are released.

Dkt. No. 808 at 5.

Nonetheless, the receiver made two proposals regarding the release of the GPs from the receivership. Under the first proposal, the receiver classified the GPs into three groups (A, B, and C) based on their ability to pay off debts and sustain their operations. *See* Dkt. No. 852 at 12-13. The receiver recommended that (1) Category A GPs, if they vote to sell, could be released from the receivership provided they pay

off their debts, (2) Category B GPs, if they voted to be released from the receivership, could only do so if they raised a certain payoff amount and paid off their debts, and (3) Category C GPs would be moved to an orderly sale without a vote, because of their weak financial condition.[2] *See id.* at 18-19. The receiver's second proposal creates the opportunity for investors that wish to retain the GP properties to raise funds to buy out those investors who wish to exit the investment. *See id.* at 20-22.

E. Pending Matters

The procedural posture of this case, and in particular, the issue regarding the receivership, has been complex. The defendants' motion to modify the preliminary injunction and remove the GPs from the receivership—the motion that resulted in the August 2013 Order—was never formally denied. *See* Dkt. No. 629 at 8-9. The Court, *sua sponte*, decided to reconsider that motion and determined in its July 2014 Reconsideration Order that the GPs should remain in the receivership. *See id.* But the Court, in that ruling, did not deny the original motion or vacate the August 2013 Order. As discussed below, the SEC asks the Court to do that now.

Relatedly, the cross-appeals in the Ninth Circuit have not yet been dismissed. Both appeals concern the August 2013 Order, and because the July 2014 Reconsideration Order did not vacate that ruling, the parties' cross-appeals on that ruling remain pending.

III. SEC'S RESPONSE TO THE RECEIVER'S REPORT

A. The Receiver Correctly Cautioned That Releasing The GPs Now Is Premature And Would Lead To Inequities

As a threshold matter, from the SEC's perspective, which is focuses on what is

[2] The "financial health" of an entity controlled by a defendant is not a factor in determining whether the controlled entity should be included in a receivership – control by the defendant is the only issue. We are not aware of any case, and defendants have cited none, that used the financial health as a basis for determining whether an entity should be included in a receivership – the test is whether the entity is controlled by the defendant.

best for the investors, the most important point in the entire report of the receiver is what the receiver warns about releasing the GPs at this point of the case. In his report, the rightly cautioned that "[r]eleasing receivership assets before deciding whether investors were defrauded is premature, extremely difficult to accomplish in a way that is fair and equitable to all investors, and unnecessarily limits, the recovery of investors who are released." Dkt. No. 852 at 5. As the receiver notes, if the trier of fact finds the defendants liable for fraud, that "determination potentially changes the relationship between investors and their GPs and the GPs and Western." *Id.* And the SEC also agrees that "[k]eeping the GPs in receivership pending the Court's determination of whether fraud occurred does them no harm." *Id.* at 6. Maintaining the GPs in the receivership, as the Court held in its July 2014 Reconsideration Order, would ensure that all of the GP investors are treated equitably.

1. The Court correctly included the GPs in the receivership

If the Court were to take into account the receivership's warnings about releasing the GPs, and keep the GPs in the receivership, the Court would be acting entirely consistent with its previous rulings. As the Court recognized in its August 2013 Order, a district court may exercise *quasi in rem* jurisdiction and include in a receivership all property in a defendant's possession or control, even if such property is nominally owned by non-parties to the action (such as the GPs here). *See* Dkt. No. 470 at 4; *SEC v. Am. Principals Holding, Inc.* (*In re San Vicente Med. Partners Ltd.*), 962 F.2d 1402, 1406-07 (9th Cir. 1992) ("*San Vicente*").

The Court's initial legal conclusion at the outset of the case to include the GPs in the receivership was proper in light of the Court's determination that the SEC had established a *prima facie* case that the GPs were securities in the form of investment contracts, and therefore investors were dependent on defendants' managerial control. *See* Dkt. No. 44, pp. 21-22. The determination that the GP interests were investment contracts meant that investors were more like limited partners or shareholders in a corporation, and the managerial/ entrepreneurial aspects of the business were

controlled by persons other than the investors. *Cf. United Housing Found. v. Forman*, 421 U.S. 837, 852 (1975). Thus, the Court's initial decision correctly included the GPs in the receivership. *See San Vicente*, 962 F.2d at 1406-08.

The correctness of the Court's initial decision to include the GPs in the receivership at the beginning of the case was later confirmed when the Court definitively ruled in its April 2014 MSJ Order that the GP interests are securities. The Court found that the purported partnership agreement did not in fact convey any powers to investors at the time of investment. *See* Dkt. No. 583, pp. 14-17. Therefore, there could be no legitimate dispute that the GPs were dependent upon and under the control of defendants. *See id.*; *see also Koch v. Hankins*, 928 F.2d 1471, 1476-77 (9th Cir. 1991) (applying *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981)). Indeed, it is for this very reason that the Court, sua sponte, elected to reconsider its August 2013 Order to release the GPs and then correctly decided, in July 2014, to keep the GPs in the receivership estate. *See* Dkt. No. 629.[3]

Inclusion of the GPs in the receivership also makes practical sense. The GPs and the investors are innocent victims of defendants' illegal sales of unregistered securities, and likely victims of defendants' alleged fraud. It is not unusual that property nominally owned by victims of securities law violators is included in SEC receivership estates. *See, e.g., San Vicente*, 962 F.2d 1406-07; *American Capital Invs.*, 98 F.3d at 1143-45. Placing the GPs within the receivership benefits the GPs and their investors. The receivership has helped, and will continue to help, the investors and the Court preserve as much of the receivership assets as possible for later distribution to investors. And as the receiver stated, while in receivership, the

[3] Indeed, the analysis under *San Vicente* is a legal issue for the court—not investors—to determine. Moreover, once a receivership is established, the partnership agreement is irrelevant. *See SEC v. American Capital Invs., Inc*, 98 F.3d 1133, 1143-45 (9th Cir. 1996) (citing *San Vicente*). Therefore, neither the receiver nor the Court, in administering the receivership, need to defer to any voting procedure provided in the partnership agreement.

GPs "are protected from creditors, their bills are paid, they pay nothing to the Receiver and the Court can react promptly to any offers to purchases their properties." Dkt. No. 852 at 6.

2. The GPs should remain in the receivership to ensure that all investors will benefit from a distribution

Not only was it legally and practically correct to keep the GPs in the receivership, it is also more equitable that they remain in the estate. Keeping the GPs in the receivership helps ensure that the largest number of investors benefit from any future distribution. The Court's holding that that the GP units are securities makes a distribution more likely because it establishes, for all practical purposes, defendants' liability on the Section 5 registration violations. Defendants have admitted that they never filed a registration statement and they have never argued that they can claim any exemption to registration. As set forth in the SEC's pending motion for partial summary judgment on its Section 5 claims, the SEC is not aware of any colorable defense defendants could raise to the registration violations. And in seeking additional time from the Court to prepare their opposition to the SEC's Section 5 Motion, defendants have focused exclusively on their need to obtain evidence to offset disgorgement; they did not mention their need to oppose Section 5 liability.[4]

The most likely measure of disgorgement for defendants' illegal offer and sale of unregistered securities would be the total proceeds defendants took in from the offerings, regardless of how defendants used those funds. The SEC would request that any disgorgement paid by defendants be included in the pool of money that would be available for distribution to investors, in addition to any funds obtained

[4] As the SEC has noted in previous filings, under Section 5, defendants would not be permitted to offset disgorgement through business expenses. *See SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010); *see also SEC v. Great Lakes Equities*, 775 F. Supp. 211, 214 (E.D. Mich. 1991) (holding that deductions from disgorgement for overhead, commissions and other expenses not warranted).

from liquidation of GP properties. Therefore, the receiver is needed to develop a claims process for the Court's approval and to propose a method of distributing any funds to investors.

Defendants recently argued, without any supporting authority, that "any potential recovery in this case will go to the U.S. Treasury and will not be distributed to any of the individual investors" because the SEC must follow a Fair Fund process to distribute such funds. *See* Dkt. No. 867 at 7. But they are wrong. A Fair Fund is not the exclusive means of distributing funds to investors. Indeed, there are numerous examples of SEC enforcement actions in which funds, including disgorged assets, have been pooled and distributed to investors in the absence of a Fair Fund.[5] *See, e.g., United States v. Real Property Located at 13328 and 13324 State Highway 75 North, Blaine County, Idaho*, 89 F. 3d 551, 553 (9th Cir. 1996) (acknowledging that proceeds from sale of disgorged property would be "placed into a fund to be distributed according to a plan by the SEC and approved by the district court."); *Capital Consultants*, 397 F.3d at 750 (affirming receiver's *pro rata* plan of distribution to harmed investors).

B. The Court Should Keep The GPs In The Receivership And Preserve The Option Of A *Pro Rata* Distribution At The End Of The Case

As for the receiver's two proposals in his report and recommendations, the

[5] Defendants also recently argued that the house Schooler sold last year was acquired before he began offering the GP interests. *See* Dkt. No. 867 at 3-4. But the timing of the purchase is irrelevant. *See SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000) ("disgorgement is an equitable remedy to return a sum equal to the *amount* wrongfully obtained, rather than a requirement to replevy a specific asset" (emphasis added) and "an order to disgorge established a personal liability, which the defendant must satisfy regardless whether he retains the selfsame proceeds of his wrongdoing" (*id.*); *FTC v. Bronson Partners, LLC*, 654 F.3d 359, 374 (2d Cir. 2011) (same, quoting first *Banner Fund* quote from preceding parenthetical); *SEC v. Henke*, 275 F. Supp. 2d 1075, 1082 (N.D. Cal. 2003) ("Disgorgement is not limited to particular assets or funds traced to the unlawful conduct."), *aff'd*, 130 Fed. Appx. 173 (9th Cir. 2005).

SEC submits that the Court should not follow either one. Instead, the Court, consistent with its prior holding, keep the GPs in the estate and retain the option of having the receiver make a *pro rata* distribution of the estate's assets to all investors.

The Court should reject the receiver's recommendations because of the inequities they would cause. Each proposal would split the investors into smaller groups, with each group treated differently. For example, the receiver's first proposal divides the GPs into three distinct groups, based on financial condition. The amount investors could recover would be based almost entirely on the identity of the GPs they invested in, an arbitrary distinction. Investors did not control which GP they invested in; the offerings were conducted one at a time. A similar result would occur under the second proposal. For those investors who retain their GP interest under that proposal, the size of any recovery would be tied to the sale price of the property. And for those who were bought out, their recovery is limited to the buyout amount; they cannot share in the proceeds of any future sale of the GP property.

Such disparate results do not further the goals of the receivership. In administering a receivership estate, a court should ensure all investors are treated fairly. *See SEC v. Capital Consultants, LLC*, 397 F.3d 733, 738-39 (9th Cir. 2005) (recognizing that the Ninth Circuit "has noted that equity demands equal treatment of victims in a factually similar case."); *see also SEC v. Wealth Management, LLC*, 628 F.3d 323, 333 (7th Cir. 2010) (citing *Cunningham v. Brown*, 265 U.S. 1 (1924) ("where investors' assets are commingled and the recoverable assets in a receivership are insufficient to fully repay the investors, 'equality is equity.'").

One option available to the receiver would be a *pro-rata* distribution to all GP investors. "Courts have routinely endorsed *pro rata* distribution plans as an equitable way to distribute assets held in receivership in this situation." *Wealth Management*, 628 F.3d at 333; *see also SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88-89 (2d Cir. 2002) ("Courts have favored *pro rata* distribution of assets where, as here, the funds of the defrauded victims were commingled and where victims were similarly situated

with respect to their relationship to the defrauders."); *SEC v. AmeriFirst Funding, Inc.*, 2008 WL 919546, at *3 (N.D. Texas 2008) ("the absence of commingling between various receivership entities does not render a pooled, *pro rata* distribution inequitable."); *SEC v. Byers*, 637 F. Supp. 2d 166, 176-78 (S.D.N.Y. 2009) (concluding "that, due to the fungibility of money, *any* commingling [of fraudulently obtained proceeds with other money] is enough to warrant treating all the funds as tainted."). There is no question that 93% of investors' funds were commingled in Western's operating account, justifying a *pro-rata* distribution here. But both of the receiver's proposals create the likely possibility that certain GPs will be released from the receivership while others would remain in the receivership. Such a result would place investors on uneven footing.[6]

Releasing any GPs from the receivership now would remove any possibility of a one-pot, *pro-rata* distribution to all GP investors later in the case. Any GPs released now would take with them the property interest that the GP holds. Any possible recovery the investors in any released GP could receive would be limited to whatever the GP may obtain from the sale of that property interest, that GPs' property interest could not be brought back later into the receivership estate. Investors in any GPs that were released now would be forced to relinquish their right to participate in any future recovery resulting from the distribution of the receivership estate. This would ensure that investors in the released GPs would receive a different recovery than those in GPs that remained in the receivership.

Furthermore, if some valuable properties were removed from the receivership, which might benefit the minority of investors in those GPs, then all other investors

[6] The receiver's first proposal suffers from an additional defect. As a default rule for Categories A and B, co-tenancies of GPs that do not have a majority of investor interests voting to sell would still be released from the receivership. Given the propriety of the receivership and the other considerations above, *the default rule should be reversed* – if a majority of investor interests do not vote to sell, then the GPs should remain in the receivership.

would unquestionably be disadvantaged. According to the receiver's 2013 valuation report, only one of the properties—owned by 3 GPs—had a market value substantially above what investors paid for it. Each of the other 22 properties, at least at the time of the report, were worth far less than investors paid. Where, as in this case, investors funds have been commingled and used primarily to run a large overall operation, the courts have often approved one-pot, *pro rata* distribution plans, even when the investors believed at the time they invested that they were investing in a particular sub-part of the enterprise. *See Credit Bancorp, Ltd.*, 290 F.3d at 88-89. A *pro rata* distribution is not the only option available to the receiver and the Court. But at least at this stage of the case, before defendants' ultimate disgorgement liability is established, the receivership estate should be preserved intact to preserve the possibility of a *pro rata* distribution as an option at the conclusion of the case.

C. The Court Should Formally Deny The Defendants' Motion To Remove The GPs From The Receivership And Vacate Its August 2013 Order

Back in March 2013, the defendants had moved to remove the GPs from the estate, and the Court granted that motion in its August 2013 Order. Once the Court concluded that the GP units were securities and that the GPs were dependent on the defendants, the Court then correctly decided to reconsider that ruling and, in July 2014, decided that the GPs should remain in the receivership. *See* Dkt. No. 629 at 7. As discussed above, that was legally, practically, and equitably the right ruling. To the extent that the Court is now reconsidering the defendants' original March 2013 motion, the SEC asks the Court to take the next logical step, and formally deny the defendants' original motion and vacate its August 2013 Order.

1. The defendants' arguments for the August 2013 Order no longer support that ruling

The arguments that the defendants made in March 2013 in favor of removing the GPs from the receivership have either been rendered moot, proven wrong or

rejected by the Court. Indeed, the defendants' primary argument in support of its motion was that GP units are not securities. *See* Dkt. No. 195-1 at 12-13. That contention is no longer relevant, as the Court has found just the opposite. *See* Dkt. No. 583 at 20. Similarly, the defendants also argued that the GPs were entitled to a pre-receivership hearing (*see* Dkt. No. 195-1 at 17), but the Court has since found that the investors have not been deprived of any due process rights (*see* Dkt. No. 629 at 7),[7] and, in any event, the Court gave investors the opportunity to be heard on the inclusion of the GPs in the receivership. *See id.* Also, while the defendants had argued that a receiver was unnecessary to manage raw land held for future appreciation (*see* Dkt. No. 195-1 at 17-20), the Court later found that the GPs are more complex to manage than even it initially believed. *See* Dkt. No. 629 at 5-6. The defendants also made the unsupported claim that the receiver was seeking to liquidate the GP properties (*see* Dkt. No.195-1 at 20-22)—a claim that has been soundly disproven because the receiver has not proposed selling any properties.

Moreover, the defendants had also claimed that the receiver had endorsed the integrity of the accounting records of both Western and the GPs. *See* Dkt. No. 195-1 at 20. But whether or not Western's books accurately recorded sums taken in and where they were transferred has nothing to do with whether the GPs and their investors depended on Western. Defendants' argument also ignored the fact that, at least from the Court's November 2012 PI order, a second purpose of the receivership was to preserve assets for likely distribution to investors. The need for preserving assets for that purpose has remained unchanged. The Court subsequently confirmed this purpose in denying defendants motion to remove Western from the receivership Dkt. No. 581. The Court concluded that "the receivership over Western remains

[7] As the SEC argued in its briefing on reconsideration, there was no due process requirement to give the GPs, or investors, a hearing at this point. The parties had fully briefed the issues and the Court ruled after considering those arguments. The SEC, however, did not object to allowing the GPs and investors to be heard.

necessary," to, among other things, "handle the likely distribution of funds to investors." Dkt. No. 598 at 5.

While the defendants' prior arguments are now moot or no longer have merit, the SEC's arguments in opposition to the defendants' original motion still support denial of that motion. *See* Dkt. No. 207 (SEC opp.); Dkt. No. 588 (SEC response to April 2014 MSJ Order). For instance, it is still true that defendants' motion to remove the GPs—filed nearly 5 months after the Court entered the preliminary injunction—was an untimely, improper motion for reconsideration of the initial determination to include the GPs because it reargued the points that defendants made in opposing a permanent receivership. The motion could and should have been denied for that reason alone. *See* Dkt. No.207 at 2-3. Moreover, the Court's determination that the GP interests are securities confirms the SEC's previous argument that the GPs depended on Western. *See id.* at 3-7; *see also* Dkt. No. 629 at 5 (central to Court's finding that the GP units are investment contracts was the Court's legal conclusion "that the GPs in this case have been found to depend on Defendants for a return on their investments").

2. The investor briefs and arguments concerning the GPs also support denial of the motion

The defendants' original March 2013 motion should be denied, and the Court's August 2013 Order should be vacated because the arguments that the self-designated GP representatives made at the October 10, 2014 hearing were mistaken, irrelevant and without merit. *See* Dkt. No. 852 at 2-4. Most speakers' objections to the receivership were rooted in their disagreement with the Court's legal conclusion that the GP interests were securities and/or their mistaken belief that prior to the receivership the investors themselves had controlled the GPs and their properties.

For example, investor Dennis Gilman— a member of a committee of seven investors formed after the July 18, 2014, hearing for the purpose of opposing the receivership—failed to recognize that it was the Court, not the SEC that placed the

GPs in the receivership. *See* Declaration of Sara Kalin, Ex. 7 (October 10, 2014 hearing transcript) at 15. Gilman also incorrectly believed that due process had required that the GPs receive a hearing prior to their inclusion in the receivership (*id*. at 15-16); believed that the partnership agreement should have prevailed over the Court's legal conclusions (*id*. at 16); and believed that the GPs must be shown to "have committed some wrongdoing" before they could be "dragged into this SEC morass" (*id.*). Gilman also admitted that many of the GP briefs had been written using templates provided by counsel for the defendants. *Id*. at 8.

Investor Gregory Post asked rhetorically whether the GPs interests were securities and answered "categorically no." *See* Kalin Decl., Ex.7 at 19. Post also claimed that the GP interests were not similar to limited partnerships because investors did not give a power of attorney to anyone. In fact, however, all the GP partnership agreements specifically state that each investor gives an "irrevocable" power of attorney to the person named in the agreement as "signatory partner." *See, e.g.*, Dkt. No. 4-17 at 12-13. Other investors also mistakenly believed that the partnership agreements controlled and that the receiver had a "fiduciary duty" to follow those agreements and obtain investors' votes on every action he might take. *See id* at 25. In fact, once an entity is in receivership, any partnership agreement that might have applied is irrelevant. *See American Capital Invs.*, 98 F.3d at 1143-45.

Many investors pointed to the balloting process provided in the partnership agreement, contending that this process gave them control over their GPs. But it is undisputed that, at least until after the Commission brought this case, the only ballots ever sent out were ones initiated by Schooler through the so-called partnership "administrators," Schuler and Jacobson, and asking for yes/no approval of actions Schooler proposed. But yes/no votes on actions proposed by a manager/promoter do not provide investors with any meaningful control of the enterprise. *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 760-61 (11th Cir. 2007). And, even if such balloting did give the investors some control over their own GP, it would not give them any control

of the property they co-owned with other GPs, and with whom they could only take action unanimously pursuant to the co-tenancy agreements. In sum, nothing raised by any GP or investor calls into question the Court's July 2014 Order ruling that the GPs should remain in the receivership.

Moreover, few, if any, of the briefs filed on behalf of the GPs reflected the views of a majority of the voting units in any GP. Out of the more than 3,400 investors in the GPs, less than 500 (15%) actually signed on to the briefs filed by 57 GPs (meaning nearly 30 did not file a brief). And as the SEC has previously pointed out, the views expressed in these briefs were largely the same, the result of centralized coordination by a handful of Schooler-affiliated investors. The SEC also provided examples where the investors who controlled the briefing process provided misinformation or excluded investors from participation. *See* Dkt. No. 784 at 3-7.

In addition, it is clear that when investors are presented with balanced and reliable information, many investors, even those who signed on to the briefs opposing the receivership, support the inclusion of the GPs in the receivership and the work of the receiver. The receiver recently disseminated his report and recommendations by email to investors in the GPs. After reviewing the report, many investors have come forward to express their appreciation and support for the receiver's work, including many who previously voted to remove the receiver in connection with the October 2014 GP briefs. *See* Kalin Decl., Exs. 1-6.

For example, Martin Sweeney wrote to the receiver stating, "I am ashamed to tell you that my last message to you was a snarky piece describing this entire exercise to be a jobs program for attorneys. I am sorry. I have just read your latest post on the E3 website and was pleased to read both of your proposals regarding GPs. Make no mistake: I no longer expect to receive a nickel's return on my investments. I simply want to be 'gone' from the whole affair. Nevertheless, I am impressed by your obvious championing of the lame and ignorant." Kalin Decl., Ex. 2 at 5. Virginia Magluyan similarly stated, "[t]here is not enough words [sic] to express both my

appreciation for your group's honest efforts and my anger toward the Schooler group. I voted to be released from your receivership efforts earlier. Now I realize that was a mistake." Kalin Decl., Ex. 5 at 12.

The Court should exercise its broad equitable authority to protect the interests of all investors, not just a small, essentially self-selected, minority who expressed their views to the Court. The purpose of the receivership, and the Court's supervision of the receiver's work, is to protect all investors who were harmed by defendants' conduct, not just the minority who are opposed to the receivership. The mistaken and/or irrelevant views of the minority should not be permitted to override the application of the appropriate legal analyses or the record evidence. The Court should therefore vacate the August 16 Order and deny defendants' motion to release the GPs from receivership.

3. Denial of the motion would conserve judicial resources

Finally, denial of the defendants' March 2013 motion to release the GPs and vacating the August 2013 Order would conserve judicial resources related to the parties' cross-appeals. The Ninth Circuit remanded the cross-appeals pending the Court's ruling on its reconsideration of the August 2013 Order. Those cross-appeals involve legal issues related solely to the August 2013 Order. Now that the Court has already determined that the GPs should remain in the receivership, it should now take the next logical procedural step and vacate the August 2013 Order. Doing so would conserve judicial resources by mooting the parties' pending cross-appeals and allowing dismissal of those appeals.

Dated: January 9, 2014

Respectfully submitted,

/s/ Sam S. Puathasnanon
Sam. S. Puathasnanon
Lynn M. Dean
Sara D. Kalin
Attorneys for Plaintiff
Securities and Exchange Commission

PROOF OF SERVICE

I am over the age of 18 years and not a party to this action. My business address is:

U.S. SECURITIES AND EXCHANGE COMMISSION
444 S. Flower Street, Suite 900, Los Angeles, California 90071
Telephone No. (323) 965-3998; Facsimile No. (213) 443-1904.

On January 9, 2015, I caused to be served the document entitled **PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S RESPONSE TO RECEIVER'S REPORT AND RECOMMENDATIONS REGARDING GENERAL PARTNERSHIPS** on all the parties to this action addressed as stated on the attached service list:

☐ **OFFICE MAIL:** By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

☐ **PERSONAL DEPOSIT IN MAIL:** By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

☐ **EXPRESS U.S. MAIL:** Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

☐ **HAND DELIVERY:** I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

☐ **UNITED PARCEL SERVICE:** By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

☒ **ELECTRONIC MAIL:** By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.

☒ **E-FILING:** By causing the document to be electronically filed via the Court's CM/ECF system, which effects electronic service on counsel who are registered with the CM/ECF system.

☐ **FAX:** By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: January 9, 2015

/s/ Sam S. Puathasnanon
Sam S. Puathasnanon

SEC v. Louis V. Schooler, et al.
United States District Court—Southern District of California
Case No. 12 CV 2164 GPC JMA
(LA-4059)

SERVICE LIST

Eric Hougen, Esq. **(served via CM/ECF only)**
Hougen Law Offices
624 Broadway, Suite 303
San Diego, CA 92101
Email: eric@hougenlaw.com
Attorney for Defendants Louis V. Schooler First Financial Planning Corporation d/b/a Western Financial Planning Corporation

Philip H. Dyson, Esq. **(served via CM/ECF only)**
Law Offices of Philip Dyson
8461 La Mesa Boulevard
La Mesa, CA 91941
Email: phildysonlaw@gmail.com
Attorney for Defendants Louis V. Schooler First Financial Planning Corporation d/b/a Western Financial Planning Corporation

Edward Patrick Swan, Jr., Esq. **(served via CM/ECF only)**
Jones Day
12265 El Camino Real, Suite 200
San Diego, CA 92130
Email: pswan@jonesday.com
Attorney for Defendants Louis V. Schooler First Financial Planning Corporation d/b/a Western Financial Planning Corporation

Ted Fates, Esq. **(served via CM/ECF only)**
Allen Matkins Leck Gamble Mallory & Natsis LLP
501 W. Broadway, 15th Floor
San Diego, CA 92101
Email: tfates@allenmatkins.com
Attorney for Court-Appointed Receiver, Thomas C. Hebrank

Thomas C. Hebrank, CPA, CIRA **(served via electronic mail only)**
E3 Advisors
401 W. A Street, Suite 1830
San Diego, CA 92101
Email: thebrank@ethreeadvisors.com
Court-Appointed Receiver