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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. 12 CV 2164 GPC JMA **FULLY AMENDED REPLACEMENT BRIEF OF ROAD RUNNER PARTNERS IN SUPPORT OF MODIFICATION OF THE PRELIMINARY INJUNCTION ORDER TO REMOVE THE REAL ESTATE GENERAL PARTNERSHIPS FROM THE RECEIVERSHIP** **Date: October 10, 2014** **Time: 1:30 p.m.** **Courtroom: 2D** **Judge: Hon. Gonzalo P. Curiel** **ORAL ARGUMENT REQUESTED**

Road Runner Partners hereby submits the following brief in favor of removing the Court-appointed receivership over them and the other real estate general partnerships ("GPs") established by First Financial Planning Corporation d/b/a Western Financial Planning Corporation ("Western") and Louis V. Schooler (collectively, "Defendants"), as authorized by the Court in its July 22, 2014 order reconsidering its earlier order of August 16, 2013 (Dkt. No. 629; hereafter "Reconsideration Order").

Road Runner Partners requests to be heard in open court at the hearing scheduled for October 10, 2014, with Gregory Post, Esq. to speak on behalf of Road Runner Partners for fifteen (15) minutes.

I.

ARGUMENT

Federal courts have broad discretion "to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership." *SEC v. Hardy*, 803 F.2d 1034, 1037 (9th Cir. 1986).

The receivership in this matter should be modified to exclude the GPs. By virtue of the express language of the Partnership Agreements and Partners' Representations executed by the investor-partners, the GPs are independent entities, completely separate from the Defendants in this litigation. Defendants have no control whatsoever over the GPs, because they cannot vote or nullify a vote. The GPs are perfectly capable of managing their properties and selling them for a profit. Whether Defendants are found liable for any violation of federal securities law is irrelevant to the issue of whether the GPs should remain in the receivership.

While the Receiver and the SEC purport to act in the best interests of the GPs, they have failed to take adequate steps to determine what the interests of the investors are, and instead have made inaccurate factual representations to the Court regarding the powers and abilities of the investors to run their GPs and sell their property.

The investors are being treated as children in a custody dispute with the Receiver serving as guardian-ad-litem, when the investors are in fact adults extremely capable of making their own decisions about their investments, including how they want to spend the money in their respective general partnership accounts.

A. The Hearing for the GPs Improperly Allows the GPs to be Heard Only after they are Placed in Receivership

At the start of this case, the SEC pointed out in its original *ex parte* TRO application: "The GPs will then have notice and an opportunity to be heard ***before*** any of their assets are placed under the control of a permanent receiver." Dkt. No. 3-1, p. 31 of 33 (emphasis added).

"[A]t a minimum [the Constitution's Due Process Clauses] require[s] that deprivation of life, liberty or property by adjudication be *preceded* by notice and opportunity for hearing appropriate to the nature of the case." *Mullane v. Central Hanover Trust Co.*, 339 U.S. 306, 313 (1950) (emphasis added). This hearing is not true due process for the GPs because *the hearing should have been provided in the very beginning,* ***before*** *the Court took control of the GPs away from their investors* and vested it in a receiver over whom the investors had no say whatsoever.

B. The SEC and Receiver Have Made Inaccurate Factual Representations and Omissions of Fact

Prior to the July 18, 2014 hearing that led to the Reconsideration Order, Nancy Kemper, an investor in two co-tenants GPs (Horizon Partners and Rainbow Partners) holding title to a residentially-zoned parcel in Las Vegas, obtained an offer from CB Richard Ellis, one of America's major real estate brokerages, to list the GPs' jointly-owned parcel for sale at $2.6 million, then circulated ballots to her fellow investors, a majority of whom voted to accept the brokerage's offer to list the GPs' jointly-owned parcel for sale. See Dkt. No. 624-3, pp. 15-16; Dkt. No. 624-6 (balloting by Rainbow Partners investors, showing 75.77% vote in favor of listing for sale); Dkt. No. 624-7 (balloting by Horizon Partners investors, showing 53.25%

vote in favor of listing for sale). None of this was initiated, requested, or coordinated by Defendants.

Notwithstanding this actual example of investor coordination, the Receiver did not sign the listing agreement with CB Richard Ellis, and the Court disregarded the Horizon Partners' and Rainbow Partners' votes on the grounds that the Receiver's counsel showed that "the listing price is...severely overinflated" based on an "erroneous assumption that the property is zoned for commercial, as opposed to residential, use" and because "the Receiver spoke with a listing agent who...came up with a listing price that is based on the correct assumption that this property is zoned for residential use and that closely approximates the appraisal obtained by the Receiver." Dkt. No. 629, 7:1-9.

The Receiver's counsel made an inaccurate factual misrepresentation and an omission of fact to the Court that resulted in the Reconsideration Order. First, the listing price report submitted by CB Richard Ellis, which was filed with the Court, correctly listed the current zoning and explained how the property was worth $2.6 million based on the allowed uses for the zoning. Dkt. No. 624-4, pp. 8-9. Second, the Receiver submitted no documentation to the Court explaining how the listing agent reached his/her determination, and in fact, the Receiver did not even identify the listing agent on the record or in any court filings. The Court did not ask for any documents from the Receiver's broker or ask questions of the (unidentified) broker before issuing the Reconsideration Order.

Thus the Court's decision in the Reconsideration Order was based on wholly unreliable statements while disregarding an detailed analysis of value that was in the record, and therefore was clear error.

C. Defendants Have No Control over the GPs or the Investors; the Receiver Now Possesses More Power than Defendants Ever Did

The SEC's entire basis for asking that the GPs be included in the receivership is the false notion that Defendants somehow "control the GPs" such that the

investor-partners are unable to exercise the powers and authority provided in the documents governing the respective GPs. Dkt. No. 3-1 at 22. But Defendants do not "control" the GPs. The Partnership Agreements clearly provide that *only* the GP investor-partners control the GPs. All partners are general partners with one vote for every unit they own, and each partner participates in the control, management, and direction of the GP. Dkt. No. 14-1, ¶ 5.1.1. The investor-partners can initiate matters for consideration by the partnership, including the distribution of information and requesting a vote of the partnership. Dkt. No. 14-1, 5.2. The investor-partners can vote to replace the Signatory Partner and Partnership Administrator. Dkt. No. 14-1, ¶¶ 4.2.3, 7.1.4.

Although Defendants can and do own equity interests in the GPs, the Partnership Agreement specifically provides that Defendants "and any and all persons or entities receiving compensation of any kind from" Defendants cannot vote on any general partnership matters, including the sale of land. Dkt. No. 14-1, ¶ 5.1.3; Dkt. No. 3-1 at 4, n. 3. Thus Defendants, either on their own or by proxy, cannot vote on issues. Nor do Defendants possess any power to veto or refuse to honor a vote of the voting investors. Defendants share in the profits of the eventual resale of the raw land to developers, but they do not get to control when the land is to be sold, to whom, and for how much, because of their complete lack of control through voting.

Neither the Receiver nor the SEC can exercise rights concerning assets that Defendants do not own and do not control. Those assets belong solely to the investor-partners who are empowered to vote. *Javitch v. First Union Sec.*, 315 F.3d 619, 625 (6th Cir. 2003) ("the general rule is that a receiver acquires no greater rights in property than the debtor had and, except for liens in existence at the time of the appointment, the receiver holds the property for the benefit of the general creditors under the directions of the court") (citations omitted).

The GP investors, by virtue of retaining control by majority vote, are true

general partners, not disguised limited partners. Yet, the imposition of the Receiver has stripped the investors of their powers. The investors had more ability to directly control, participate in, and influence their investment before the Receiver was imposed upon the GPs than they do now. By imposing the Receiver upon the GPs, the Court has turned the investors from general partners with full authority to direct their investment into *de facto* limited partners dependent upon the whims of the Receiver's oversight, thereby creating a self-fulfilling prophecy.

Therefore, the Receiver must be removed from control of the GPs.

D. The Investors in the GPs Are Capable of Managing Their Partnerships and Property and Selling the Land for a Profit without the Receiver's Guidance or Control

In the Reconsideration Order, the Court found that the GPs should remain in the receivership because of "day-to-day operations [that] are not as simple as the Court previously thought them to be," such as Western buying out dissatisfied investors' interests, Western loaning money to GPs for funding shortfalls, the presence of a water system on GPs' property, and persons residing rent-free on GP property. Dkt. No. 629, 6:5-15.

However, these matters are nothing new – the SEC and Receiver previously raised them unsuccessfully in opposition to Defendants' earlier motion to remove the GPs from receivership. Dkt. No. 207 at 3-5 (SEC opposition); Dkt. No. 206 at 3 (Receiver's opposition). The Receiver admitted that the "GPs may be able to hire somebody to perform some of these functions performed by Western (and possibly survive without others)." Dkt. No. 206 at 3. And, in fact, the GPs have always possessed that authority in the Partnership Agreements, which authorize the investors by simple majority vote to fire the partnership secretaries and hire new ones. Dkt. No. 195-3 at 12, ¶ 7.1.4 (allowing termination of Partnership Administrator by majority vote, with or without cause). The ability to hire and fire at will was relied upon by the Ninth Circuit in a similar case to determine adequate

control by investors. *Holden v. Hagopian*, 978 F.2d 1115 (9th Cir. 1992).

Therefore the Reconsideration Order is inappropriate because when the Court issued its earlier modification order in 2013 (Dkt. No. 470), the Court already knew what the GPs' regular operations were. Nothing has truly changed that makes the continuation of an involuntary, unconsented receivership appropriate.

The investors include people from all walks of life who are fully capable of making sure property taxes and insurance are paid each year and that an accountant is engaged to prepare Form K-1's. Less is needed to maintain and operate the GP than is required to maintain one's own home finances, and this Court has agreed. Dkt. No. 470, 25:11-17.

Even in those rare and limited cases in which residential tenants or a water system are present – matters affecting less than a half-dozen of the 86 GPs in existence, namely the partnerships for the Stead/P51 property in Reno, Nevada – the investors can take action by voting on whether to have tenants reside on the premises, whether to hire someone to tend to the water system, etc. If the tenants do not vacate the premises, the GP investors can vote to hire an attorney to bring an unlawful-detainer action against the tenants. The GP investors can vote to hire a manager to run the water system. The SEC and Receiver have never provided any evidence that the investors are incapable of taking such action. And for the overwhelming majority of GPs that have neither a water system nor tenants, the operational requirements remain minimal: payment of taxes, insurance, and mortgages, and issuance of tax statements.

Receivers are usually appointed to operate or manage a business when the business is being so mismanaged that investors' funds are jeopardized and in danger of wrongful dissipation. However, when the business at issue consists of a general partnership with very simple routine activity and an asset whose increase in value is based on macroeconomic factors outside of the partnership's control, there is nothing to mismanage and hence nothing to justify the appointment of a receiver to

protect the investors.

The securities-fraud cases invoked by the SEC in its memorandum of points and authorities in support of its TRO application (Dkt. No. 3-1) were complex business activities that had a real-estate component. The cited cases typically involved improved property such as orange groves (*SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)), jojoba farms (*Koch v. Hankins*, 928 F.2d 1471 (9th Cir. 1991)), and apartment buildings (*McConnell v. Frank Howard Allen & Co.*, 574 F.Supp. 781 (N.D. Cal. 1983)). In those cases, there was an active business enterprise that took place on a piece of real estate, which is markedly distinct from simply owning the undeveloped real estate and leaving it alone to appreciate in value as neighboring properties are developed, as in this case. Without active management, or with mismanagement of the day-to-day operations, the investments in *Howey*, *Koch*, and *McConnell* were doomed to fail.

In contrast, the GPs in this case were established solely for investment in raw land that would be held for the long term, until such time as the surrounding area had developed. The GPs are not established to develop their lands, nor do they actually do so. Those complex activities would be done by the developers after they had bought the land from the GPs. The defined purpose, as presented in the Partnership Agreements and Partner's Representations, was for the GPs to hold the land until, in the investors' opinion, the time was right to sell.

Furthermore, the Co-Tenancy Agreements by which the GPs hold fractional interests to their properties do not undercut the investors' ability to operate the GPs and sell their property at a profit. The Co-Tenancy Agreement plainly and expressly states that any individual partner in any of the co-tenant GPs can simply request a ballot to be issued not only within his/her own GP, but for that ballot to also be issued for a vote of all the members of all the other co-tenant GPs. Dkt. No. 210-1, §3.5.1.

Any individual investor has the ability to force a vote to be taken by his/her

GP and also all of the co-tenant GPs on any business matter relevant to the GPs. It is actually a very simple process that gives each investor direct and immediate ability to bring a matter of business to a full vote upon a mere request. There is no requirement that a member's GP first vote on the issue of whether a ballot request be sent to the other co-tenant GPs, and there is no requirement that each GP's investors must unanimously vote a certain way; all that is needed is that *a simple majority of the investors in each co-tenant GP* vote in favor of selling, etc.

Contrary to what the Court believes in the Reconsideration Order, the Co-Tenancy Agreements do not require that "hundreds, if not thousands of investors, would have to communicate and collaborate before a property may, for example, be sold." Dkt. No. 629, 6:20-23. Instead, all it takes is one investor to request that the co-tenant GPs be balloted, followed by the two GP secretaries distributing the ballots to the investors, followed by the investors (on their own) voting. There is no coordination necessary, and the investors are capable of doing this without guidance or instruction by Defendants, as shown recently by Ms. Kemper's locating a brokerage, obtaining an offer to list, and then initiating the ballot process whereby the investors in both co-tenant GPs were able to cast a vote on whether to list the property with that brokerage.

Neither the SEC nor the Receiver, despite their best efforts (Dkt. Nos. 584, 588, 589), has provided any evidence showing that the GPs are incapable of governing themselves or deciding the appropriate time to sell their assets. Therefore, the receivership over the GPs should be lifted immediately.

E. Whether Defendants Are Liable for Any Violations of Federal Securities Law is Irrelevant

The Court's order of April 24, 2014, which *sua sponte* reconsidered its earlier decision to release the GPs from the receivership, and which led to the Reconsideration Order, was based on its finding as a matter of law that the GP equity interests were securities. Dkt. No. 583, 20:20-26. The SEC and Receiver

further argue that the GPs should be included in the receivership to protect them from Western's possible financial failure. However, as even the SEC acknowledges, "***the GPs are separate entities from Western***." Dkt. No. 3-1, p. 23 (emphasis added). The GPs are not parties to this case; they are not and have never been accused of collaborating with Defendants to swindle investors. They are and always have been legally-independent entities.

The financial health and legal future of Defendants has *no impact* on the financial health and future of the GPs. Whether or not Western continues to exist - whether or not the SEC obtained judgment against Defendants for any violation of the securities laws - the GPs will still own title to land. The return on their investment continues to turn on the same factors that existed the day they entered into the investment: when will a party be interested in purchasing the property from the GP, and at what price? Those are the same factors that have generated profits for past GPs; the present litigation does not change those factors. There is nothing that needs to be done to maintain title to the property and eventually sell to another party that the GPs, through their investors working in concert, cannot do on their own without the Receiver.

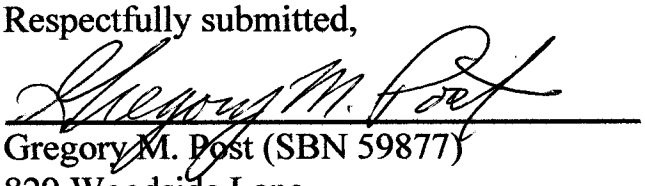
II.

CONCLUSION

Based on the foregoing, Road Runner Partners respectfully request that this Court honor its partners' majority vote and modify the preliminary injunction order to be removed from the receivership.

DATE: September 10, 2014

Respectfully submitted,



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ROAD RUNNER PARTNERS

Group - YUMA II- 1/4 INTEREST WITH DESERT VIEW, SONORA VIEW & MESAS VIEW

Response to Letter& Ballot - August 2014
Re: Removal of Receiver

	Partner
	[redacted]
1	Melissa A Post
2	Gregory M Post
3	Patricia C. Buza, IRA
4	Sally Costa
5	Paul T Grandi, Trustee
6	Michael Loguidice, IRA
7	Jamie Lupo
8	Karen R Schiltz, IRA
9	Daniel J. Schultz
10	Edward Costa, IRA
11	Susan L Fuller, IRA
12	Douglas G Clarke, IRA
13	Kenneth Garland, IRA
14	Lisa A Walz, IRA
15	William D Schneider
16	Robert Indihar, IRA
17	William L Lefler & Susan D'Vincent
18	Michael J & Georgene L Swanberg, Trustees
19	Kelly Lee Lawrence
20	Robert W Churchill, IRA
21	Rick J & Diana G Schwering, Trustees
22	Dana Smith - Self Directed Traditional IRA
23	John Bollenbacher
24	Phyllis Charlton, Trustee
25	Karen Mattmann
26	Gary A Powell, IRA
27	Kevin B. Bacon & Karin Bacon, Co-Trustees
28	David F Macy & Elaine A Macy,Trustees
29	Roland Ramirez