Eric J. Hougen (SBN 258968)
Law Offices of Eric J. Hougen
624 Broadway, Suite 303
San Diego, CA 92101
Telephone: (619) 702-1000
Facsimile: (619) 702-1005

Philip H. Dyson, Esq. (SBN 097528)
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
(619) 462-3311

Edward Patrick Swan, Jr., Esq. (SBN 089429)
Jones Day
12265 El Camino Real, Suite 200
San Diego, CA 92130
Telephone: (858) 703-3132
Facsimile: (858) 314-1150

Attorneys for Defendants

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

DEFENDANTS' REPLY BRIEF IN SUPPORT OF MOTION FOR MODIFICATION OF PRELIMINARY INJUNCTION ORDER TO REMOVE THOMAS C. HEBRANK AS COURT-APPOINTED RECEIVER

Date: February 13, 2015
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

Defendants LOUIS V. SCHOOLER ("Schooler") and FIRST FINANCIAL PLANNING CORPORATION d/b/a WESTERN FINANCIAL PLANNING CORPORATION ("Western") (collectively "Defendants") respectfully submit this reply brief in support of their Motion for Modification of this Court's Preliminary Injunction to remove Thomas C. Hebrank ("Mr. Hebrank") as Court-Appointed Receiver and disqualify the law firm of Allen Matkins Leck Gamble Mallory & Natsis LLP ("Allen Matkins") from providing legal services to the receivership.

I.

ARGUMENT

A. Mr. Hebrank's Deliberate Destruction of Emails Constitutes Spoliation of Evidence and Hence Justifies His Removal

In one of the most astounding claims ever made by a purported neutral officer of a court, Mr. Hebrank states in his opposition:

> Finally, ***there is nothing improper about not retaining e-mails*** that are not important to ongoing issues in the receivership. IT specialists recommend deleting and purging old e-mails that are no longer necessary to avoid computer delays and crashes from storing excess data. Moreover, the Receiver produced three banker's boxes of e-mails and attachments to Schooler's counsel. While Schooler would obviously like his fishing expedition into the Receiver's e-mails to consume even more time and resources than it already has, ***there is nothing improper about deleting old e-mails***.

Dkt. No. 948, 10:10-18 (emphasis added).

E-mails, like traditional documents, constitute evidence in their own right and are discoverable as leading to the production of admissible evidence. Parties have a duty to preserve documents and electronically stored information (ESI) when they have notice of (1) litigation or the potential for litigation and (2) the document's or data's potential relevance to the actual or potential litigation. *See Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 216 (S.D.N.Y. 2003). Since Mr. Hebrank was appointed as the Receiver at the outset of the case and is mandated to provide

periodic reports to the Court, he was on notice of actual litigation and that the emails he received or created in connection with his service as court-appointed receiver were potentially relevant to the litigation – particularly when his reports were used by the SEC for support of their dispositive motions.

The deliberate destruction of evidence is a serious violation of the constitutional right to due process and results in severe sanctions under the law.

California law forbids the intentional spoliation of evidence, both civilly and criminally. The spoliation of evidence is subject to civil sanctions during litigation, including (1) the evidentiary inference that the evidence which one party has destroyed or rendered unavailable was unfavorable to that party (Cal. Evid. Code § 413); (2) discovery sanctions including terminating sanctions (Cal. Code Civ. Proc. § 2023); and (3) disciplinary action against the attorneys for the party. *Cedars-Sinai Medical Center v. Superior Court*, 18 Cal.4th 1 (1998).[1]

Federal law also prohibits the spoliation of evidence. In *Apple Inc. v. Samsung Elecs. Co., Ltd.*, 881 F.Supp.2d 1132, 1147 (N.D. Cal. 2012), the court held that "it generally is recognized that when a company or organization has a document retention policy, *it is obligated to suspend that policy and implement a 'litigation hold' to ensure the preservation of relevant documents after the preservation duty has been triggered.*" (Emphasis added.) The *Apple* court then held that Samsung's failure to halt its biweekly email destruction policy for the duration of the litigation was willful and granted Apple's motion for an adverse-

---

[1] The willful spoliation or attempted willful spoliation of evidence is a crime. Cal. Pen. Code §§ 135, 664; *People v. Hill*, 58 Cal. App. 4th 1078, 1089 (1997) ("The purpose of section 135 is to prevent the obstruction of justice").

In criminal cases, the government's failure to preserve exculpatory evidence violates the defendant's due process rights and is grounds for a court order dismissing the case against the defendant or reversing a conviction. *California v. Trombetta*, 467 U.S. 479 (1984); *Arizona v. Youngblood*, 488 U.S. 51 (1988).

inference jury instruction against Samsung. *See also Jackson Family Wines, Inc. v. Diageo N. Am., Inc.*, 2014 U.S. Dist. LEXIS 19420 (N.D. Cal. Feb. 14, 2014) (monetary sanctions and adverse-inference instruction levied against defendants for deleting computer hard drive of defendants' employee several months after start of litigation, where destruction of evidence not revealed until deposition of employee).

And as this Court so aptly stated in *Cottle-Banks v. Cox Communs., Inc.*, 2013 U.S. Dist. LEXIS 72070 at *38 (S.D. Cal., May 21, 2013)(Curiel, J.):

> "A litigant is under a duty to preserve what it knows, or reasonably should know, is relevant in the action, is reasonably calculated to lead to the discovery of admissible evidence, is reasonably likely to be requested during discovery, and/or the subject of a pending discovery request." *Wm. T. Thompson Co. v. General Nutrition Corp.*, 593 F.Supp. 1443, 1455 (C.D. Cal. 1984); *In re Napster, Inc. Copyright Litigation*, 462 F. Supp. 2d 1060, 1067 (N.D. Cal. 2006)("As soon as a potential claim is identified, a litigant is under a duty to preserve evidence which it knows or reasonably should know is relevant to the action.") "[O]nce a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a 'litigation hold' to ensure the preservation of relevant documents." *Zubulake v. UBS Warburg LLC*, 220 F.R.D. 212, 218 (S.D.N.Y. 2003). "The scope of the duty to preserve extends to electronic documents, such as emails and back-up tapes." *AAB Joint Venture v. United States*, 75 Fed. Cl. 432, 441 (2007).

Mr. Hebrank not only failed to preserve his emails, but knowingly and intentionally deleted them.

Although Mr. Hebrank is not a party *per se* in the SEC litigation, as he does not file a complaint or an answer, or present a case at trial or receive a verdict, he is analogous to a party, as he files motions with the Court requesting that actions be taken, orders issued, and sanctions levied. Therefore, he is so similarly situated to the SEC and Defendants that he should be subject to the same rules and restrictions, ***including the prohibition on deliberate destruction of evidence that he has flouted.***

Mr. Hebrank cites no case law whatsoever to support his contention that he, *as a neutral representative and officer of the Court*, is allowed to destroy evidence

such as emails. Nor could he do so. Indeed, ***his contention is so utterly bizarre that even the SEC does not join it – the SEC's opposition to Defendants' Motion is silent as to the issue of Mr. Hebrank's spoliation of evidence.***

Mr. Hebrank's defense that "IT specialists recommend deleting and purging old e-mails that are no longer necessary to avoid computer delays and crashes from storing excess data" (Dkt. No. 948, 10:12-14) fails because courts have held that ***normal document and email retention policies do not control when litigation is ongoing***. *Apple Inc. v. Samsung Elecs. Co., Ltd.*, 881 F.Supp.2d at 1147.

It is the height of hypocrisy that, at a time when Mr. Hebrank has had Mr. Schooler held in contempt for not allowing unfettered access to a computer server containing Western's electronic records and emails, notwithstanding any lack of evidence of any document or email destruction by Mr. Schooler (see Dkt. No. 833), Mr. Hebrank has deliberately destroyed his own electronic records and emails.[2]

Receivers in other cases have been removed from office for deliberately destroying evidence. *See e.g.* Bertrand Marotte, *Receiver Removed from Stanford Case*, The Globe and Mail, Sept. 11, 2009, available at http://www.theglobeandmail.com/report-on-business/receiver-removed-from-stanford-case/article4315340 (last visited Jan. 26, 2015) ("An Antigua-based receiver that destroyed original computer evidence from the Montreal offices of alleged fraudster Allen Stanford's global bank - and refused to share the copies with Canadian and U.S. authorities - has been removed from the case and severely reprimanded by a Quebec judge"). Thus, Defendants' motion is neither novel nor unsupported by law or fact.

Mr. Hebrank's destruction of evidence interfered with Defendants' ability to present a defense. Defendants are entitled to access all of Mr. Hebrank's email

[2] Despite Mr. Hebrank's counsel stating that Western's computer servers would be returned to Western after Mr. Hebrank had arranged to have them removed for copying in December 2014, Mr. Hebrank has not returned the servers to Western.

communications with the SEC as they are relevant to bias, conflict of interest, and other matters that call Mr. Hebrank's competence and veracity into question. ***Mr. Hebrank's unilateral decision to destroy those emails denies Defendants their right*** to present such a defense. It also prejudices their ability to show that the Receiver's reports, which the SEC is relying so heavily on in its pending motion for summary judgment, are the result of bias and collusion with the SEC.

Furthermore, Mr. Hebrank's claim that Defendants should be satisfied with the three bankers' boxes of documents produced and not complain about ***his deliberate destruction of evidence*** is consummate arrogance, for it is not for Mr. Hebrank, *as an officer and agent of the Court*, to unilaterally determine the extent of the discovery that Defendants can conduct; that is reserved for the Court.

Therefore, Mr. Hebrank should be removed from office and his counsel disqualified.

B. Because Mr. Hebrank is a Neutral Arm of the Court, He Has No "Shared Interest" That Permits His Entanglement with the SEC, and there is No Legal Support for the Contention that They Are Entitled to Collude

As Defendants have noted, Mr. Hebrank, as a court-appointed receiver, is "not an agent of either party to the action" but "acts as a fiduciary on behalf of both parties as a representative and officer of the court." *Sec. Pac. Nat'l Bank v. Geernaert*, 199 Cal.App.3d 1425, 1432 (1988). Mr. Hebrank is "an 'officer of the court' – not an arm of the Commission." Dkt. No. 174 (Preliminary Injunction Order), p. 9, fn. 7, ¶ 2, citing *In re San Vicente Medical Partners*, 962 F.2d 1402, 1409 (9th Cir. 1991).

Notwithstanding these clear legal directives, the SEC and Mr. Hebrank claim that Mr. Hebrank has a "shared interest" with the SEC that makes his collaboration with the SEC, his sharing of communications only with the SEC, and his seeking legal advice from the SEC entirely proper. Dkt. No. 946, 5:17-11:21; Dkt. No. 948, 3:22-26, 5:3-13, 9:18-19. However, neither the SEC nor Mr. Hebrank produce any

law supporting their position that a court-appointed receiver, as a neutral officer of the court, is allowed to collaborate solely with one party in litigation. Mr. Hebrank has done so and therefore has shown himself to be an agent of the SEC. Therefore, his immediate removal is warranted.

C. The Receiver's and SEC's Remaining Arguments are Risible

1. The Extent of Mr. Hebrank's Collusion with the SEC Demonstrates that Defendants' Challenges to the Receivership Have Been Justified All Along

Mr. Hebrank complains that Defendants "[have] repeatedly attacked and tried to undermine the receivership at every opportunity" by "knowingly misrepresenting the facts to the Court and investors" such as "[making] false representations includ[ing] that the Receiver is charging investors exorbitant fees, has unilaterally obtained appraisals at their expense…intends to fire sell [sic] their properties…and has refused to sign listing agreements, thereby costing them millions in lost opportunities." Dkt. No. 948, 1:19-2:3.

Having been exposed as having acted as the SEC's agent instead of an office of the Court, Mr. Hebrank tries to distract the Court from his errors by claiming that Defendants' hands are dirty with misrepresentations. He fails on two grounds.

First, Defendants have not been engaged in misrepresenting any facts to the Court or to investors. For example, Defendants have striven to correct Mr. Hebrank's incomplete information provided to investors by pointing out – correctly – that Mr. Hebrank's exorbitant fees harm the investors. This occurs, as Defendants have repeatedly explained before (Dkt. Nos. 463, 505, 537, 609), by depleting Western's accounts of funds, which requires backfilling from the GP accounts through accelerated payments of the GP-to-Western notes, which means that there is less money available to the GPs for paying property taxes, insurance, and secretarial fees, which means that the investors have to be tapped more often for funds.

///

Second, Mr. Hebrank fails to acknowledge that he has, in fact, refused to sign listing agreements and instead proposed actions that would result in the fire-sale of GP-held properties. In the case of Rainbow Partners and Horizon Partners, Mr. Hebrank refused to sign a listing agreement from CB Richard Ellis, America's premier commercial real-estate broker, to list those GPs' Las Vegas lot for $2.6 million, based on the flawed assumption of a local appraiser (Mr. Lubawy) who believed he knew more about real estate and local land use and zoning than CBRE's Las Vegas brokers did. *See* Dkt. Nos. 624-4, 624-5. Defendants have also shown how Mr. Hebrank's proposals in his Receiver's Report and Recommendations Regarding General Partnerships have various conditions that make the GP investors' votes to escape the receivership illusory (thereby resulting in sale of the property contrary to majority vote) and force several GPs to sell their land without taking a vote as to whether to remain in receivership or not. *See* Dkt. No. 874.

Defendants agree that Mr. Hebrank has been subject to "[t]he endless assault of motions." Dkt. No. 948, 2:16. There is a reason for that. Defendants have always contended that Mr. Hebrank has been acting in the wrong, and as the deposition testimony and subpoenaed emails have shown, ***Defendants were right all along: Mr. Hebrank's conduct was improper, and his removal is necessary***.

2. Mr. Hebrank Did Not Act With the Best Interests of the Investors in Mind, But With the Best Interests of the SEC in Mind

The SEC contends that Mr. Hebrank acted with the investors' best interests in mind throughout the case. However, the SEC's arguments on this issue also fail.

The SEC's response to the Receiver's Report and Recommendations Regarding General Partnerships, which the SEC presents as "evidence" that it is not allied with Mr. Hebrank (Dkt. No. 946, 9:10-13), is contrived.

At the time the SEC filed its response to the Receiver's Report and Recommendations, it had been served with Defendants' motion to remove Mr. Hebrank. Faced with the documentary evidence of its collusion with Mr. Hebrank

in the research and preparation of the Receiver's Report and Recommendations (see Dkt. No. 860-4, pp. 6-12), the SEC orchestrated its response that purported to object to Mr. Hebrank's proposals, even though – as pointed out by Defendants – the proposals would lead to the SEC's desired result, the destruction of the GPs and sale of their lands at fire-sale prices (which would "prove" the SEC's contention that the investors had been defrauded). Dkt. No. 874, pp. 7-12.

The SEC also claims that "All this [the emails] shows is that Mr. Hebrank solicited, considered, and then accepted suggestions from the SEC" and that "[the SEC and Mr. Hebrank] merely held the same view on the issue [of the GPs being released from the receivership] and wanted to ensure that their respective briefs did not undermine the others' arguments." Dkt. No. 946, 9:28-10:1, 10:18-19.

These statements by the SEC beg the question: ***If the SEC seriously claims that Defendants are wrong and that Mr. Hebrank is not an agent of the SEC, then why is Mr. Hebrank, as a purportedly neutral arm of the Court who is not supposed to be affiliated with either party, soliciting suggestions from the SEC and collaborating with the SEC on which arguments to make in court filings?***

The SEC cannot have it both ways: either…

- Mr. Hebrank is supposed to be a neutral, independent arm of the Court who is not an agent of either side – which would make his collaboration with the SEC improper and in derogation of his responsibilities and duties as an arm of the court, or…
- Mr. Hebrank is entitled to collaborate with the SEC in the first place, which means he cannot be a neutral, independent person and hence cannot be the receiver.

Because these are mutually-exclusive positions, the SEC's argument fails; in either position, Mr. Hebrank acts not in the best interests of the investors, but in the best interests of the SEC, and therefore he should be removed forthwith.

///

3. The GPs and Investors Would Not Suffer Harm from Mr. Hebrank's Removal

The SEC claims Mr. Hebrank's removal would "result in substantial hardships for the investors." Dkt. No. 946, 12:9-16. This argument is "sheer speculation" (Dkt. No. 946, 12:9) of the sort that the SEC attributes to Defendants.

First, appointing a new receiver would not "delay the final distribution and conclusion of the receivership estate," contrary to the SEC's claims. Dkt. No. 946, 12:10-11. There has been no trial or formal adjudication of any liability, let alone any judgment decreeing disgorgement of ill-gotten gains or restitution to investors. No final distribution or conclusion of the receivership estate is imminent.

Second, Mr. Hebrank's removal would not "complicate an already complex situation regarding the estate itself." Dkt. No. 946, 12:12-13. Western and the GPs have been under receivership for almost two and a half years. All assets have been accounted for. The forensic accounting for Western and the GPs was completed over a year ago and no commingling or misappropriation was found. The notes from Western to the underlying sellers and from the GPS to Western will still be paid if a new person is appointed to replace Mr. Hebrank.

Lastly, the SEC's claim that replacing Mr. Hebrank would "generate unnecessary fees and costs" and "[c]reat[e] new financial and administrative burdens" is speculative because the fees and costs and administrative burdens of an unnecessary receivership will continue with or without Mr. Hebrank.[3] The removal of Mr. Hebrank and disqualification of Allen Matkins may *reduce* the fees and costs by allowing the appointment of less-expensive yet equally-qualified replacement receivers and counsel.

Therefore, the SEC's remaining reasons should be disregarded.

---

[3] The majority of Mr. Hebrank's current duties could be performed by the new partnership administrators whom Mr. Hebrank has asked the Court to hire (see Dkt. No. 852, 27:17-28:26).

II.

CONCLUSION

For the reasons stated above and in their Motion, Defendants respectfully request that this Court modify the Preliminary Injunction to remove Mr. Hebrank and appoint a new receiver, and to disqualify the law firm of Allen Matkins from providing any further receivership-related legal services in this case.

Both Mr. Hebrank and the SEC choose to ignore this Court's reminder that "***a receiver is an 'officer of the court' – not an arm of the Commission***." Dkt. No. 174 (Preliminary Injunction Order), p. 9, fn. 7, ¶ 2, citing *In re San Vicente Medical Partners*, 962 F.2d 1402, 1409 (9th Cir. 1991) (emphasis added). They instead present the astonishing and legally-unjustified position that a court-appointed receiver, as a "representative and officer of the court" (*Sec. Pac. Nat'l Bank v. Geernaert*, 199 Cal.App.3d 1425, 1432 (1988)), is entitled to deliberately destroy evidence rather than produce it under subpoena and to serve as an agent of the government because of a purported "shared interest."

These contentions have only served to prove the point that Defendants have been making all along in their filings with the Court: that Mr. Hebrank provides no benefit to the investors, but instead provides benefit only to the SEC. Hence, Mr. Hebrank must be removed immediately, and Allen Matkins disqualified from providing further legal services in support of the receivership.

DATE: January 30, 2015

Respectfully submitted,

/s/Philip H. Dyson

Philip H. Dyson, Esq. (SBN 097528)
Law Office of Philip H. Dyson
8461 La Mesa Boulevard
La Mesa, CA 91942
Counsel for Defendants

CERTIFICATION

I hereby certify that on the 30th day of January 2015, I electronically filed the foregoing with the Clerk of the District Court using the CM/ECF system, which sent notification of such filing to the following counsels of record:

Sam S. Puathasnanon, Esq.
Sara D. Kalin, Esq.
Lynn Dean, Esq.
Securities and Exchange Commission
444 S. Flower Street, 9th Floor
Los Angeles, CA 90071

Ted Fates, Esq.
Allen Matkins Leck Gamble Mallory & Natsis LLP
501 West Broadway, 15th Floor
San Diego, CA 92101

/s/Philip H. Dyson
Philip H. Dyson