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9 and FIRST FINANCIAL PLANNING CORPORATION

10 **UNITED STATES DISTRICT COURT**
11 **SOUTHERN DISTRICT OF CALIFORNIA**

13 SECURITIES AND EXCHANGE)
14 COMMISSION,)

15 Plaintiff,)

16 v.)

17 LOUIS V. SCHOOLER and FIRST)
FINANCIAL PLANNING)
18 CORPORATION d/b/a WESTERN)
FINANCIAL PLANNING)
19 CORPORATION,)

20 Defendants.)
21)

Case No. 12 CV 2164 GPC JMA

**DEFENDANTS' REPLY TO THE
RECEIVER'S AND PLAINTIFF
SECURITIES AND EXCHANGE
COMMISSION'S RESPONSES TO
OBJECTIONS TO THE COMMISSION'S
PROPOSED PRELIMINARY INJUNCTION
ORDER AND ORDER APPOINTING
THOMAS C. HEBRANK PERMANENT
RECEIVER**

22 Defendants LOUIS V. SCHOOLER ("Schooler") and FIRST FINANCIAL PLANNING
23 CORPORATION ("Western") (collectively "Defendants"), by and through their attorneys of
24 record, Eric J. Hougen and Philip H. Dyson, respectfully submit this Reply to the Receiver's and
25 Plaintiff Securities and Exchange Commission's Response to Objections to the Commission's
26 Proposed Preliminary Injunction Order and Order Appointing Thomas C. Hebrank Permanent
27 Receiver.
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1 Disregarding the appropriate roles and obligations of a court-appointed receiver and a
2 federal agency that is a party to civil litigation, Thomas Hebrank, the Court-appointed receiver
3 (“Receiver”) and Plaintiff Securities and Exchange Commission (“Commission”) have essentially
4 joined forces to fight the revisions to the proposed preliminary injunction order that Defendants
5 made in their Objections. In doing so, they disregard the Court’s November 30, 2012 order (Dkt.
6 N. 59), in which it proposed that the Receiver serve the limited purpose of clarifying Western’s
7 financial situation. They instead argue for a broad receivership that has virtually unlimited,
8 unnecessary powers that in no way fit the specific facts and circumstances of the present case
9 before this Court. True to form thus far in the litigation, the Commission continues to elevate its
10 status beyond that of a normal litigant and proposes to give itself access to *all* of Western’s
11 material -- the kind of access that it would never have pursuant to its enforcement powers, much
12 less any powers it has under the Federal Rules of Civil Procedure as a party to litigation. The
13 Receiver and Commission’s tag-team approach to the preliminary injunction order once again
14 demonstrates the kind of overreach that has dominated their actions since the beginning of this
15 litigation, and Defendants respectfully request that the Court adopt Defendants’ proposed changes
16 to the preliminary injunction order.

17 **A. Page 5, Section IV, subparagraph J (and Commission Section VI) – Western’s**
18 **Counsel of Record in this Litigation Should Be Allowed to Continue to Represent**
19 **Western in this Matter.**

20 Defendants propose to revise the Commission’s preliminary injunction order to allow
21 Western’s counsel to continue to represent Western and serve as counsel of record in this matter.
22 The Commission and the Receiver collaborate to oppose this change, arguing that the Receiver
23 has “full power” over Western and that allowing Western to continue to have its current counsel of
24 record represent it in this matter is somehow contrary to Western’s interests.

25 But this completely misreads the purpose that this Court has ordered for the receivership.
26 After carefully considering the parties’ arguments and the Receiver’s report, the Court concluded
27 that there was “no need for a receiver to marshal and preserve assets from misappropriation,” but
28 solely “to clarify Western’s financial matters” and “business structure.” Dkt. N. 59 at 9-10. Until

1 such a clarification is made, the Court found, “it is unknown whether a receiver would be helpful
2 in collecting revenue on behalf of Western,” or “whether facts and information will come to light
3 bearing on Schooler’s ability to manage Western and/or claims Western might have against its
4 management.” *Id.* at 10. The Court approved “the Receiver’s recommendation as to asset
5 evaluation, forensic accounting analysis, reporting, and claims review and distribution plan,” and
6 ordered that he proceed solely with those duties for now. *Id.* at 10-12.

7 The Court did not order the kind of broad, overarching powers over Western that the
8 Commission and the Receiver have assumed. Instead, the Court ordered that the receiver
9 undertake limited duties simply “to clarify” Western’s financial affairs. In doing so, the Court was
10 simply exercising its broad power to “determine the appropriate action to be taken in the
11 administration of the receivership.” *S.E.C. v. Hardy*, 803 F.3d 1034, 1037 (9th Cir. 1986).
12 Despite the Receiver’s and Commission’s rush to implement total control over Western, a
13 receivership holds no greater power than that granted by the court, which has discretion to tailor it
14 according to the needs of the situation. *See S.E.C. v. Loving Spirit Found.*, 392 F.3d 486, 490
15 (D.C. Cir. 2004) (“A receiver’s authority ... is defined solely by the order of the appointing court,
16 which may provide for the administration of the receivership in any way it sees appropriate.”); *see*
17 *also Javitch v. First Union Sec., Inc.*, 315 F.3d 619, 626 (6th Cir. 2003) (“[Whether a receiver]
18 stands in the shoes of an entity in receivership ... depends on the authority granted by the
19 appointing court and actually exercised by the receiver.”); *S.E.C. v. Elfindepan, S.A.*, 169 F. Supp.
20 2d 420, 424 (M.D.N.C 2001) (“Because the receiver is under the direct control of the court, which
21 defines the receiver’s powers and places limitations upon her, the scope and nature of a particular
22 receivership will depend on the language of the order appointing the receiver.”).

23 Accordingly, there is no risk of “confusion” by investors as to who “speaks and acts” for
24 Western, as the Receiver warns (see Receiver Response at 2), since the Court has not authorized
25 *anyone* to speak and act on Western’s behalf; it has authorized that the Receiver for now
26 undertake limited duties, none of which involves discussing matters concerning this litigation.
27 Similarly, there is no risk that the Receiver would not have access to material covered by the
28 attorney-client privilege, since such access does not represent a waiver of the privilege, as he

1 recognizes in his response. (Receiver Response at 3).

2 By contrast, the Receiver's and Commission's proposal *would* create the risk of a number
3 of conflicts of interest. As a court-appointed receiver, Mr. Hebrank is an officer of the court,
4 "neither a plaintiff nor defendant." *Loving Spirit Found.*, 392 F.3d at 490. Yet the Receiver and
5 the Commission are proposing that the Receiver's attorney simultaneously represent the Receiver,
6 Western, and the general partnerships -- the alleged "defrauded parties"-- at the same time in this
7 litigation. Similarly, it would be impossible for the Receiver to fulfill his duties to the Court while
8 also fulfilling his duties to oversee a vigorous defense of Western in this matter, as management of
9 any corporation is obligated to do in any litigation.

10 Finally, it is disingenuous for the Receiver to complain that "Western's limited financial
11 resources should be preserved and protected for investors, and not used for attorney fees and other
12 litigation expenses" (Receiver Response at 3) while signing off on a proposed order that would
13 require Western and partnerships to subsidize payment of the Receiver, along with any attorneys
14 he retains to represent Western in the litigation.

15 **B. Pages 5-6, Commission's Section VIII (as corrected, Section VII) – The Stay**
16 **Provision Should Apply to Both Defendants in this Matter as Originally Ordered**
17 **by This Court.**

18 Without citing any authority, the Commission asserts that the Court lacks authority to stay
19 litigation against Schooler during the pendency of this action. The Commission takes this position
20 now despite the fact that the Commission itself asked the Court for this exact same stay provision
21 regarding Schooler in its TRO Application, which also did not ask for Schooler to be included
22 within the receivership requested by the Commission. (Dkt. Doc. 3). The Court's initial order
23 included a stay regarding Schooler. (Dkt. Doc. 10).

24 The edit to this Section proposed by Defendants simply **restores** this section to the original
25 language submitted by the Commission in its Ex Parte Application for the TRO (Dkt. Doc. 3) and
26 the Temporary Restraining Order issued in this matter (Dkt. Doc. 10).

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1 Defendants therefore ask the Court to adopt Defendants' proposed language so as to avoid
2 duplicative litigation that would waste the resources of not only Schooler, but also those of the
3 federal courts, and possibly those investors who out of confusion believe they need to race to the
4 courthouse to secure a claim (a claim the Commission would undoubtedly criticize and/or possibly
5 even block, should it result in any one investor reaching a verdict or settlement ahead of the SEC's
6 litigation concluding).

7 **C. Page 7-8 (Commission's Section XII (as corrected, Section XI) – The Commission is**
8 **an Ordinary Litigant and Should Not Be Exempt from the Limitations of the**
9 **Federal Rules of Civil Procedure.**

10 In the same breath, the Commission claims not to seek exemption from the Federal Rules
11 of Civil Procedure, and then argues that it is not "an ordinary litigant" and should essentially be
12 exempt from the Rules by having access to *all* of Western's documents -- as it describes, a
13 "natural extension of its enforcement responsibilities." Commission Response at 5-6. The
14 Commission ignores its own duplicity and complains that Defendants' proposal "would prevent
15 the Receiver from voluntarily sharing any information with the Commission pre-discovery, even
16 in instances where the Commission has not made a request." *Id.* at 5.

17 The Commission fails to address the well-established case law establishing that it *is* an
18 ordinary litigant, and as the matter proceeds, it *is* subject to all procedural rules. *United States v.*
19 *Procter & Gamble Co.*, 356 U.S. 677, 681 (1958); *SEC v. Collins & Aikman Corp.*, 256 F.R.D.
20 403, 414 (S.D.N.Y. 2009). It's particularly important that the Commission be required to adhere
21 to proper procedural rules, as courts have recognized, in this action that *it* initiated and in which it
22 seeks severe penalties that are quasi-criminal in nature. *See SEC v. Merkin*, 283 F.R.D. 689, 693-
23 94 (S.D. Fla. 2012); *see also SEC v. Snyder*, No. H-03-04658, 2006 WL 6508273, at *1 (S.D.Tex.
24 Aug. 22, 2006).

25 Further, the Commission provides *no* basis for why the Receiver -- who, as explained
26 above, is an officer of the Court and acts only within the scope of the Court's orders -- should be
27 allowed to share information with the plaintiff in this matter, either "pre-discovery" or at any other
28 point. The procedural rules would have no meaning if a party, even a powerful government

1 agency, has the power to collaborate with an insider to obtain an unfair advantage over a litigation
2 adversary.

3 As drafted, the Commission's proposal would allow it to circumvent the Receiver and
4 would grant it authority beyond any exercised pursuant to any of its "enforcement
5 responsibilities." The Commission would have the authority "to inspect or copy *any or all*" of
6 Western's documents, regardless of whether they were relevant to this litigation or any
7 enforcement action. By contrast, if the Commission were acting pursuant to its subpoena power, it
8 would have to identify the relevant topics and allow Western to review material for responsiveness
9 or privilege before producing it; the Commission could not simply step in and obtain *any and all*
10 material, as it proposes here. If the Commission were seeking material pursuant to its enforcement
11 powers -- and not as a litigant in this matter -- it would have no need to confirm it in a preliminary
12 injunction order at issue in this litigation; it would simply seek the material through appropriate
13 means.¹

14 Finally, the Commission's proposal of absolute and unfettered access would completely
15 violate the attorney-client privilege. The Commission fails to explain how its role as civil plaintiff
16 and the mere appointment of a receiver should allow the Commission to violate Western's
17 attorney-client privilege and have greater access to documents than permitted under any of its
18 other powers. Thus, the PI Order should make clear that the Commission, like all other civil
19 plaintiffs, should not be exempt from the limitations of the Federal Rules of Civil Procedure and
20 should be required to use the appropriate FRCP Rules of Discovery to request documents from
21 Defendant Western. The existence of the receivership does not change these basic legal standards.

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25 ¹ The Commission's own enforcement manual discourages its staff from using such tactics:
26 "[S]taff should not use investigative subpoenas solely to conduct discovery with respect to claims
27 alleged in the pending complaint. A court might conclude that the use of investigative subpoenas
28 to conduct discovery is a misuse of the SEC's investigative powers and circumvents the court's
authority and the limits on discovery in the Federal Rules of Civil Procedure." Securities and
Exchange Commission Division of Enforcement Manual at 42 (available at
<http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>).

1 **D. Page 4, Section IV, subparagraph E – Defendants’ Financial Records Should Be Filed**
2 **Under Seal.**

3 The preliminary injunction order proposed by the Commission would require the Receiver
4 to file publicly his accounting report concerning Western. The Commission and the Receiver
5 contend this is necessary because the allegedly “defrauded investors” each have a “significant
6 stake in the receivership estate.” Commission’s Response 3; Receiver’s Response to Objections to
7 Proposed Preliminary Injunction Order (Dkt. Doc. 72) (“Receiver’s Response”) at 2.

8 As an initial matter, there are no “investors” found to have been “defrauded” at this stage.
9 The Court has concluded solely that the Commission satisfied a minimal showing for a
10 preliminary injunction. Indeed, the parties have not even begun discovery, and there has been no
11 resolution to Defendants’ motion to dismiss. It is therefore premature to require the public filing
12 of the Receiver’s accounting, which will include private, sensitive, and proprietary information
13 belonging to a private company.

14 Second, Western’s sole “investor” is Louis Schooler. None of the partners in the general
15 partnerships holds any shares or interest in Western. The investors are not shareholders of
16 Western. The Commission’s allegations that investors should have claims to Western’s assets are
17 merely that: allegations. The Commission, without a trial verdict in this matter, cannot simply
18 transmute the General Partnership members and other members of the general public into parties
19 holding a legal share in Western, a privately held company. As Defendants have explained
20 thoroughly, the partnerships’ success or failure in no way depends on the financial affairs of
21 Western (*see* Defendants’ Objections (Dkt. Doc. 70). The purpose of the Receiver to investigate
22 and report to the Court regarding the disputed facts can be fully met with the filing of Western’s
23 financial records under seal.

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CONCLUSION

Based on the foregoing, Defendants respectfully request that this Court adopt the Defendant's Proposed Preliminary Injunction Order and Order Appointing Thomas C. Hebrank Permanent Receiver. See Dkt. Doc. 70-1 for a redline version of the proposed PI Order showing Defendants' proposed changes to the Commission's Proposed PI Order. See Dkt. Doc. 70-2 for a clean version of Defendants' Proposed PI Order.

Respectfully submitted,

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CERTIFICATION

I hereby certify that on the 24th day of January, 2013, 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:

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