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19 and FIRST FINANCIAL PLANNING CORPORATION

20 **UNITED STATES DISTRICT COURT**
21 **SOUTHERN DISTRICT OF CALIFORNIA**

22 SECURITIES AND EXCHANGE
23 COMMISSION,

24 Plaintiff,

25 v.

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

Defendants.

Case No. 12 CV 2164 GPC JMA

**DEFENDANTS' RESPONSE TO
FIFTH INTERIM APPLICATIONS
FOR APPROVAL AND PAYMENT OF
FEES AND COSTS (RECEIVER AND
COUNSEL)**

Date: February 21, 2014

Time: 1:30 p.m.

Ctrm: 2D

Judge: Hon. Gonzalo P. Curiel

1 Defendants LOUIS V. SCHOOLER and FIRST FINANCIAL PLANNING
2 CORPORATION (collectively “Defendants”) respond as follows to the Fifth
3 Interim Applications for Approval and Payment of Fees and Costs to the Court’s
4 appointed receiver, Thomas C. Hebrank, CPA (“Receiver”), and the Receiver’s
5 counsel, Allen Matkins Leck Gamble Mallory & Natsis LLP (“Receiver’s
6 Counsel”).

7 I.

8 INTRODUCTION

9 The Receiver, on behalf of himself and Receiver’s Counsel, has now filed
10 five interim applications for payment of fees and costs involving the continued
11 receivership of Western Financial Planning Corporation (“Western”) and the real
12 estate general partnerships (“GPs”), with the fifth application covering the period of
13 July 1, 2013 through September 30, 2013.

14 The Receiver and Receiver’s Counsel claim to have incurred a total of
15 \$182,249.66 in fees and costs for work performed for those three months, with
16 \$106,015.50 in fees and \$1,014.91 in costs for the Receiver, and \$73,707.75 in fees
17 and \$1,511.50 in costs for Receiver’s Counsel. *See* Dkt. Nos. 525, 526. These fees
18 are calculated after a 10% fee discount for the Receiver. Dkt. No. 525, 1:15-17.

19 Defendants object to the Fifth Interim Applications on several grounds. First,
20 during the time period at issue, the Receiver, despite having available cash in
21 Western’s bank account, stopped making payments on the seller-financing
22 carryback notes that Western owes to the original sellers of the GP-owned properties
23 (the “Underlying Notes”). This inaction by the Receiver also occurred during the
24 time period of the Fourth Interim Applications and after the time period of the Fifth
25 Interim Applications, as Defendants have previously and repeatedly brought to the
26 Court’s attention. *See* Dkt. No. 407, 17:7-21 (nonpayment of May and June 2013
27 installments); Dkt. No. 505, 4:4-6:23 (nonpayment of May, June, August, and
28 September 2013 installments); Dkt. No. 520, 5:1-6:1 and Declaration of Louis V.

1 Schooler, *infra* (nonpayment of October and November 2013 installments and
2 noteholders' Notices of Default).

3 Therefore, the Receiver must be required to certify to the Court that all
4 Underlying Notes are current before the Court approves any portion of the Fifth
5 Fee Applications, because the Receiver is not complying with this Court's
6 directive of August 16, 2013 to make the payments on the Underlying Notes. The
7 Receiver had the GPs continue to pay their GP note obligations to Western, but then
8 did not use that cash to pay the corresponding Underlying Note obligations. That
9 caused cash to accumulate in Western's account – cash that will undoubtedly have
10 been used by the Receiver to pay his fees upon approval of the Third and Fourth Fee
11 Applications, since it was not used to pay the Underlying Notes.¹

12 The money that the GPs have paid to Western on the GP Notes has been paid
13 with the express understanding and obligation, under the all-inclusive deed of trust,
14 that Western will apply those funds directly to the corresponding Underlying Notes.
15 The Court must not allow the Receiver to divert those funds to payment of his own
16 fees. The Receiver's duty of care to the receivership entities – including Western -
17 requires that available cash be used to pay existing obligations. The Court must not
18 allow the Receiver to prioritize his fees ahead of existing secured obligations, the

19 _____
20 ¹ As of October 25, 2013, the date of Defendants' Opposition to the Fourth Fee
21 Applications, the Receiver refused to pay the scheduled payments for August 2013
22 and September 2013 on the Underlying Notes, despite sufficient cash on hand.
23 Defendants' attorneys requested an explanation from the Receiver's counsel in
24 writing, but received no response whatsoever. As a result of the Receiver's
25 unresponsiveness, Mr. Schooler's [Western's] staff contacted seven of the
26 beneficiaries on the Underlying Notes, all of whom reported (in mid-to-late
27 October) that their loans were in default with payments or late fees still outstanding
28 for August 2013. Three of the beneficiaries had mailed Notices of Default (NODs)
but had not yet recorded NODs against the GPs' titles yet. Needless to say, the
Receiver's behavior during the time of the Fifth Fee Applications was an
extraordinary abuse of discretion and merits nothing but his removal from control of
Western.

1 nonpayment of which not only breaches the Receiver's duty of care to the
2 receivership entities, but puts the GPs' title interests at risk through the Receiver's
3 parasitism on Western.

4 Second, even if the Underlying Notes are brought current by the Receiver and
5 remain current, the fees and costs to be recovered by the Receiver continue to be
6 unreasonable and excessive in light of the lack of benefit to the receivership entities
7 and the evidence that the Receiver's actions have unnecessarily caused actual harm
8 to the receivership entities. For example, the Receiver's paying himself ahead of the
9 Underlying Notes has prioritized repayment of lowest-priority unsecured, non-
10 recourse debt ahead of higher-priority secured debt. The Receiver cannot be
11 allowed to be paid for actions that are a direct breach of his duty of care to the
12 receivership entities.

13 Therefore, Defendants request that the Fifth Interim Applications be *denied*.
14 In the alternative, to the extent the Court decides to approve any portion of the Fifth
15 Interim Applications, the Receiver must first be required to bring the Underlying
16 Notes current and keep them current.

17 II.

18 ARGUMENT

19 A. THE FEE APPLICATION MUST NOT BE APPROVED UNLESS 20 AND UNTIL THE RECEIVER CERTIFIES THAT HE HAS 21 APPLIED ALL FUNDS RECEIVED FROM THE GPs TO THE 22 CORRESPONDING UNDERLYING NOTES OWED BY WESTERN TO THE ORIGINAL SELLERS

23 Beginning in late May 2013, during the time period that was the subject of the
24 Fourth Fee Application, the Receiver stopped making payments on Western's behalf
25 for the Underlying Notes. *See* Dkt. No. 407, p. 17 of 27 (listing payments not made
26 by Receiver, which were due in June and early July 2013). This trend continued
27 through the period of the Fifth Fee Application and continues even today. *See* Dkt.
28 Nos. 505, 520. The money that the GPs provided to Western as payment for the

1 GPs' notes to Western, which would otherwise have been applied by Western as
2 payments on the Underlying Notes, accumulated in Western's accounts, presumably
3 as a source of funds for the Receiver and his counsel to tap as the Fee Applications
4 are granted.

5 The Receiver claimed – incorrectly -- that he did not make the payments
6 because (a) there is a limited amount of cash and (b) he needs the funds to pay
7 Western's employees and pay the other expenses associated with the proposed move
8 of Western's operations. *See* Dkt. No. 455, p. 9 of 14, ll. 7-9 (“Western does not
9 currently have enough cash to make all mortgage payments and pay its basic
10 operating expenses”).²

11 Despite the discretion afforded to receivers, they are still bound by the limits
12 of the law and the duties of care owed to the receivership entities. The Receiver
13 owes a duty of care to Western and the GPs while Western and the GPs remain
14 under receivership. When he makes the GP Note payments on behalf of the GPs, he
15 knows the GPs expect a corresponding payment from Western on the Underlying
16 Notes, as all the documents setting forth the underlying relationships require. The
17 Receiver's diversion of those funds to other uses, such as paying his fees or his
18 counsel's fees or covering Western's operational expenses, is not permitted. The
19 Receiver is obligated to apply those funds to the Underlying Notes ahead of
20 everything else. The duty of care the Receiver owes to Western requires it, but he
21 has repeatedly breached that duty – and violated this Court's orders - by causing a
22 default on a secured debt when there is available cash and no higher priority
23 payment obligation required.

24 On July 18, 2013, during the period covered by the Fifth Fee Application,
25 Defendants' counsel sent a letter to the Receiver's Counsel advising that the

26 ² The Receiver's statements are false because Western has only one part-time
27 employee (the GP secretaries being independent contractors) and because Schooler,
28 not Western, paid the costs associated with the move of the offices.

1 Receiver had failed to make payments on the Underlying Notes that were due in
2 June and July 2013. *See* Dkt. No. 463-1 (declaration of Philip H. Dyson), ¶ 3. In
3 response to the letter, the Receiver’s Counsel called Philip H. Dyson, co-counsel for
4 Defendants, on the afternoon of Friday, July 19, 2013. Dkt. No. 463-1, ¶ 4. During
5 the phone conversation, the Receiver’s Counsel stated that the reasons for the non-
6 payment of the Underlying Notes were that “there is a small amount of cash, and he
7 [the Receiver] needs monies to pay employees and pay whatever expenses there are
8 in moving,” a reference to the pending sale of the building housing Western’s and
9 the GPs’ offices and the relocation of the staff. Dkt. No. 463-1, ¶ 4. The Receiver’s
10 Counsel then stated that the Receiver was working on a cash-flow analysis and
11 would know by the following Monday (July 22, 2013) what payments the Receiver
12 was going to make. Dkt. No. 463-1, ¶ 5.

13 The Receiver did not provide any cash-flow analysis or list of payments by
14 July 22, 2013, but instead filed a Surreply to Defendants’ Motion for Modification
15 of Preliminary Injunction in which he claimed he had made “the majority of the loan
16 payments” listed in Defendants’ Reply - but without specifying which payments
17 were made and when. *See* Dkt. No. 455, p. 9 of 14, ll. 10-12; Dkt. No. 463-1, ¶ 7.
18 The Receiver has claimed that he “has managed to continue to make payments on
19 mortgages secured by GP properties and will continue to make all such payments as
20 cash is available.”

21 Nevertheless, as of this date – six months later, and after repeated requests by
22 Defendants both in filings with this Court and in correspondence with the Receiver’s
23 counsel - the Receiver has not provided a list of payments, while the beneficiaries of
24 the Underlying Notes have written and continue to write to Western to report that
25 the Receiver has not made the payments.

26 The Receiver’s failure to pay has caused great harm to Western, the GPs, and
27 the investors, with more trouble on the horizon unless the Receiver is ordered to
28 resume the underlying payments. For instance, in the case of the Dayton II

1 property, held by the Storey County, Comstock, Silver City, and Nevada View GPs,
2 the Receiver's decision to stop collecting operational funds and failure to pay the
3 Underlying Notes has resulted in the property being at risk of default and
4 foreclosure for failure to make the 120th and final underlying note payment. Other
5 noteholders have notified Western, time and again, of the Receiver not paying the
6 notes – even though the Court has directed the Receiver to do so.

7 The Receiver needs to be required to present a full accounting demonstrating
8 the current payments on all Underlying Notes before any consideration should be
9 given to his pending fee applications. To date, he has not provided one. Unless and
10 until such a showing has been made, the Fifth Fee Applications should be denied.

11 **B. THE FEES AND COSTS CLAIMED ARE STILL**
12 **UNREASONABLE WHEN COMPARED TO THE RESULTS**

13 Upon applying the factors of *SEC v. Fifth Avenue Coach Lines*, 364 F.Supp.
14 1220, 1222 (S.D.N.Y. 1973) to the fee applications, there are many areas in which
15 the applications fall short. There is no great complexity of problems faced, and the
16 benefit to the receivership estate is nonexistent; as stated above and at length in
17 other documents, the Receiver's continued existence is highly detrimental. *See* Dkt.
18 Nos. 195, 205, 407. The Court has ultimately agreed with regard to the GPs, since
19 the receivership over the GPs is now to be dissolved. Dkt. No. 470.

20 The problems faced were not truly complex at the beginning of the
21 receivership and did not grow more complex during the summer and early fall of
22 2013 (and have not grown more complex since). There are the same number of
23 entities, bank accounts, properties, and investors relevant to the receivership; the
24 accounts in that period remained with the same bank as before; the entities remained
25 in their common office in San Diego with common storage; and the entities
26 continued to hold only raw land with no day-to-day management required – the
27 same situation as the day the receivership began.

28 ///

1 Furthermore, the continued receivership over Western is utterly unnecessary.
2 There has been no proof of fraud, money laundering, or offshoring of funds. The
3 Receiver has completed his forensic accounting of Western, thus clarifying
4 Western's financial affairs (*see* Dkt. No. 59). Therefore, there is no reason for the
5 Receiver to be in place at all.

6 The court is not "required to fix fees in total disregard of the fact that this
7 receivership produced a very lean harvest, that all interests suffered heavily, and that
8 the whole enterprise was not a success." *Specialty Products Co. v. Universal Indus.*
9 *Corp.*, 21 F.Supp. 92, 94 (M.D. Pa. 1937).

10 The result obtained by the Receiver is a critical factor. *SEC v. Elliott*, 953
11 F.2d 1560, 1577 (11th Cir. 1992); *United States v. Code Products Corp.*, 362 F.2d
12 669, 673 (3d Cir. 1966). Since there has been no indication as to the results
13 obtained through the Receiver's labors to date, the Receiver's work "merits an
14 'incomplete' grade" and therefore the fee application should be denied in its entirety
15 or else the award should be reduced significantly. *In re Alpha Telcom, Inc.*, 2006
16 U.S. Dist. LEXIS 79997 at *16 (D. Or. Oct. 27, 2006).

17 III.

18 CONCLUSION

19 The Fifth Application for fees and costs requested by the Receiver and
20 Receiver's Counsel should be denied. The requested fees and costs continue to be
21 unreasonable under the circumstances. There is no showing as to how the work
22 performed between July 1, 2013 and September 30, 2013 has benefitted Western (or
23 the GPs, for that matter). In fact, there is greater evidence that the actions taken by
24 the Receiver during that period, such as the nonpayment of the Underlying Notes,
25 causing many Underlying Notes to go into default, depleting available funds for
26 lowest priority unsecured debt when existing secured debt obligations remain
27 unpaid, and the decision to stop operational billing of the GP investors, have caused
28 **tangible**, measurable harm to the receivership entities. The Receiver should not be

1 allowed to collect his fees when he has in fact breached the duty of care he owes to
2 the receivership entities.

3 Furthermore, the Receiver's fees cannot be justified by Defendants defending
4 themselves against the Receiver's rapacity. The Receiver is not entitled to fees
5 merely because Defendants sought the due process to which they are entitled by law
6 instead of acquiescing to the Receiver's parasitism and collaboration with the SEC.
7 Parties cannot recover for their own wrongs.

8 For all of the reasons set forth above, Defendants request that the Fifth
9 Interim Applications be *denied*. In the alternative, to the extent the Court decides to
10 approve any portion of the Fifth Interim Applications, the Receiver must first be
11 required to bring the Underlying Notes current and keep them current.

12 DATE: January 17, 2014

Respectfully submitted,

13 /s/Philip H. Dyson

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CERTIFICATION

I hereby certify that on the 17th day of January 2014, 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:

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