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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

DEFENDANTS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THEIR MOTION FOR MODIFICATION OF THE PRELIMINARY INJUNCTION ORDER TO REMOVE THE REAL ESTATE GENERAL PARTNERSHIPS FROM THE RECEIVERSHIP

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1 Defendants LOUIS V. SCHOOLER ("Schooler") and FIRST FINANCIAL
2 PLANNING CORPORATION d/b/a WESTERN FINANCIAL PLANNING
3 CORPORATION ("Western") (collectively "Defendants") respectfully submit the
4 following Points and Authorities in support of Defendants' Motion for Modification
5 of this Court's order of October 5, 2012 (final order March 13, 2013) granting a
6 preliminary injunction and appointing a receiver for Western and the real estate
7 general partnerships established through Western. Defendants move for
8 modification of the preliminary injunction to dissolve the receivership as to the real
9 estate general partnerships.

10 **I.**

11 **INTRODUCTION**

12 The real estate general partnerships ("GPs") formed through Western's real
13 estate syndication activities have been wrongfully pulled into the receivership
14 imposed on Western. The GPs should immediately be removed from the
15 receivership for the following reasons:

16 1. The GPs are wholly independent, free-standing, third-party entities.
17 The Securities and Exchange Commission ("SEC") has failed to submit
18 evidence supporting its allegation that the GPs are controlled by
19 Western. Thus, it is inappropriate to include the GPs within the scope
20 of the Western receivership.

21 2. To the extent Western owns any units in the GPs, those units have
22 always been and continue to be non-voting units, further demonstrating
23 the lack of any ability for Western to control the GPs.

24 3. The GPs (as independent, third-party, non-defendants in this case) have
25 never been provided with the due process requirements of notice and an
26 opportunity for a hearing required under the law before a receivership
27 can be imposed on third-party non-defendants. A hearing was provided
28 for Defendants, but no similar hearing has ever been provided to the

1 GPs.

2 4. The receivership over the GPs has taken control away from and
3 imposed direct additional costs upon the very investors the SEC claims
4 to be protecting.

5 5. There is no threat, danger, or risk to the GPs or to the GPs' land
6 investment for which the Receiver is necessary to protect the GPs.

7 6. After three years of investigation by the SEC and an additional nine
8 months of forensic analysis by the Receiver, not one instance of
9 misappropriation of funds, commingling, or other financial
10 mismanagement has been identified or even alleged as to the GPs or
11 Western. In fact, the Receiver has found all amounts accounted for and
12 has determined the accounting records for Western and the GPs to be
13 "accurate and reliable" – enough so as to rely on them fully in issuing
14 his recent Forensic Report.

15 7. Any speculative concern regarding potential mismanagement of the
16 GPs originally alleged by the SEC in its TRO application that may have
17 served as a basis for the initial inclusion of the GPs within the
18 receivership has now been demonstrated to not exist.

19 8. The GPs do nothing more than hold raw land. Their operational needs
20 are extremely simple: merely paying property taxes and insurance and
21 once a year retaining an accountant to prepare the Form K-1's. There
22 is no ongoing day-to-day management needs requiring a costly receiver
23 and receiver's counsel.

24 9. The operational duties for the GPs have been successfully carried out
25 for more than 30 years by partnership administrators at the extremely
26 nominal cost of $100 to $400 ***per month***, as opposed to the Receiver's
27 fees of $250 ***per hour***.

28

10. The Receiver has implicitly endorsed the integrity and ability of the very persons who have been handling all GP administrative duties for the past 30 years. The Receiver has kept all of the same persons in their same capacities to take care of the exact same needs that they have accurately and reliably carried out for the GPs for over three decades. The only difference since September 2012 has been that the GPs' return on their investment has been eaten into by the increased cost of an expensive Receiver looking over the shoulders of the administrators.

11. To the extent the Court felt it necessary at the outset of this case to address the SEC's various allegations by appointing a receiver to take full inventory and achieve "lockdown" of all bank accounts and other records, that goal has now been fully accomplished for months now. The SEC's hypothetical concerns of capital flight or other financial mismanagement have been shown to have never existed and certainly to no longer be of concern now or in the future.

12. This Court has recognized in this matter that "there may be no need for a receiver to marshal and preserve assets from misappropriation and dissipation" and importantly delineated the purpose of the Receivership to be that of "clarify[ing] Western's financial affairs." Dkt. No. 59, p. 9 of 12. This careful instruction from the Court has not stopped the Receiver from continuing to expand his role beyond that mandated by the Court. In particular, rather than focusing on completing a report to the Court that could very easily have clarified Western's financial affairs by now, the Receiver has spent considerable time, resources, and energy on appraisals that the Receiver has recently announced will be provided to the Court together with his recommendation regarding potential dissolution of GP assets. It is simply premature for the Receiver to be jumping to recommendations regarding final dissolution

of GP assets before (1) completing his report to the court regarding Western's financial affairs, or (2) having taken any steps to inquire of the investors whether they want their money spent in this manner.

13. Finally, removal of the GPs from the receivership will in no way hinder or otherwise prejudice the SEC's ability to fully litigate all pending claims against Defendants. Any further imposition of unnecessary and excessive costs on the investors at this juncture – before the SEC has even carried the burden of proving its case at trial – is unwarranted.

All of the above reasons for removing the GPs from the receivership fall into three primary categories:

A. The General Partnerships are Wholly Separate Entities from Western

Central to all of these issues has been the SEC's repeated attempts to conflate the GPs with Western on a theory that the GPs are controlled by Western. This assertion is simply not true. The only role Western plays with regard to the GPs is in assisting with the initial administrative steps necessary to the formation process, but once the GPs are formed, they immediately become free-standing, independent general partnership entities. The GPs, just like any other business entities choosing to operate in the form of a general partnership, are imbued with all the rights and privileges provided to the general partnership form and governed by their respective General Partnership Agreements ("GP Agreements").

While Western does normally invest in the GPs by purchasing units alongside the other investors, *Western and anyone affiliated with Western who holds any units in the GPs are specifically prohibited by the terms of the GP Agreements from voting on any GP business matters of any kind.* Western holds units as a non-voting member. Any and all decisions by the GPs, including how to respond to any offers from developers to purchase the property, can only be made by the voting members.

Try as the SEC might, it cannot turn Western's extreme minority position and non-voting member status into a controlling position. By the very terms of the GP Agreements governing the respective GPs, Western has no ability to even vote on GP matters, let alone control or otherwise exercise any authority whatsoever regarding the GPs. Once formed, the GPs are wholly independent, free-standing, self-operating entities with all of the control, power, and authority given to any group of individuals choosing to operate in the form of a general partnership.

B. The General Partnerships' Due Process Rights Have Been Violated

The law imposes specific notice and due process requirements before a receivership can be imposed upon a party. The Defendants were provided with notice and an opportunity for a hearing with regard to the receivership imposed on Western. However, the GPs have not been provided with such an opportunity for a hearing regarding the imposition of a receivership over them.

The SEC understands this due process requirement. In its original application for a temporary restraining order, the SEC recognized and provided the Court the additional assurance that "the GPs will … 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. And yet, to date, no such hearing has been provided. The SEC has been content to push for the receivership over the GPs without any concern for the lack of due process given to the individual investors.

Defendants believe the GPs should immediately be removed from the receivership, but at a bare minimum, a hearing should be provided for the GPs to be heard directly by this Court on the issue of whether they want, need, or can be forcibly subjected to a costly receivership that deprives them of control of the title to the land everyone agrees they rightfully own.

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C. The Receivership Over the General Partnerships is Wholly Unnecessary Going Forward

Unlike many going concerns that must rely on active day-to-day management to succeed, the GPs do nothing more than hold raw land. There is no day-to-day management. Each GP must pay property taxes and insurance and once a year engage an accountant to prepare the Form K-1's. There is no other active management or operations to be overseen. The required tasks are exceedingly simple. There is no need for a costly Receiver and Receiver's counsel for the GPs to write checks three or four times a year.

The Receiver has already blessed the accounting records of both the GPs and Western as being "accurate and reliable" in his Forensic Accounting Report (Part One). Dkt. No. 182, p. 19 of 20. Any speculative concerns identified by the SEC in September 2012 about financial malfeasance or commingling or unaccounted for transactions have been erased. Any concern by the Court that the Receiver needed to take inventory of all assets, bank accounts, and records belonging to the GPs no longer exists. Full inventory and lockdown has been accomplished. No mismanagement has been identified. All that is left are the original causes of action brought by the SEC against the Defendants, not the GPs – causes of action that will in no way be prejudiced or otherwise hindered by allowing the GPs to now be removed from the receivership.

If the SEC has a case to make regarding its claims that Western sold an unregistered security and failed to make all material disclosures regarding the price paid for the property, the SEC can do so without tying the GPs up in a receivership. After all, the case law is clear that a receivership is "not an end in itself." The receivership must have a defined purpose.

After three years of investigation and nine months of a receiver having full and complete access to all books and records, there has yet to be one single claim or allegation of operational or financial malfeasance. There is no claim that GP funds

were misappropriated. There is no claim that there was improper commingling. The SEC's most aggressive claims are that Western artificially inflated the offering price. The SEC does not identify any ongoing operational malfeasance from which the GPs need the protection of a receiver on an ongoing basis. Nor has the SEC alleged that the GPs themselves participated in any such operational malfeasance or any wrongdoing.

The Receiver has had ample opportunity to take possession of all records and can thus conduct any and all reviews and analysis, and produce any and all forensic or other reports relevant to the assets, books, and records in this matter. It does not necessitate his continued oversight of extremely simple, basic payments of property taxes and insurance. These functions have been ably handled by partnership administrators for more than three decades without incident; the Receiver himself has attested to this fact.

Thus, the receivership over the GPs has served whatever purpose it needed to serve and it has no more reason for imposing additional costs on the investors, thereby reducing the investors' return on their investment every day the GPs remain subject to the receivership.

Defendants have approached the SEC with these concerns regarding how the receivership has actually taken control away from and imposed direct economic harm on the investors. Defendants furthermore asked for the SEC's input on how to return full control back to the investors in an efficient and timely manner. Defendants are hopeful that the SEC, in the interests of the investors, will support this motion so that the litigation the SEC has brought against the Defendants can proceed without imposing continued unnecessary costs on the investors.

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II.

BACKGROUND

The SEC has attempted to present the GPs as much more complicated than they are and to try to turn them into limited partnerships and/or subsidiaries of Western. A true understanding of the investment structure and the investors' full control of the GPs is important to an appropriate analysis of why the GPs should be removed from the receivership.

A. Western's Real Estate Syndication Structures

Schooler has owned and operated Western since 1978. Decl. of Louis V. Schooler ("Schooler Decl."), § 2. Schooler has held a California real estate salesperson's or broker's license since 1986, and Western has been registered with and regulated by the California Department of Real Estate (DRE) since 1988. Schooler Decl., § 3. Neither Schooler nor Western have ever been the subject of DRE disciplinary action. Schooler Decl., § 4. Schooler is also licensed in Nevada, and has no history of discipline there. Schooler Decl., § 5.

Schooler's original real estate syndication projects involved groups of investors holding title to raw land as tenants-in-common. However, because the sale of land owned as tenancies-in-common required a unanimous vote, tenancies-in-common were not flexible enough for investment purposes.

From the late 1970's onward, Schooler has used GPs as the means of investment syndication. The use of GP's provides investors with (1) maximum control of all aspects of the investment vehicle through majority rule of the voting members, and (2) greater flexibility than a tenancy-in-common since only a bare majority vote is needed to decide when to sell, to whom to sell, and for how much. Schooler Decl., § 6.

The GPs are formed solely to invest in undeveloped land for the purpose of obtaining profits from property appreciation on resale. Dkt. No. 1, ¶ 2; Schooler Decl., § 7. Any return on investment depends solely on market appreciation, not on

1 any skills of Defendants, the GPs, or any other entity. The GPs make their own
2 decisions on when to sell the land and at what price. The GPs that have sold their
3 property to an end buyer have all experienced significant returns – often providing
4 individual investors with double digit annualized returns on their investment.

5 The GPs operate pursuant to partnership agreements. (*See* Statement and
6 Agreement of Partnership of P-40 Warhawk Partners, attached hereto as Exhibit 1.)
7 Under those agreements, there are no limited partners or managing partners. (*Id.*)
8 All partners are general partners. (*Id.)* Any partner units held by Western or any
9 person or entity connected in any way to Western are non-voting units – they are not
10 allowed to vote on any GP ballots of any kind. (*Id.* ¶ 5.1.3) All other partners are
11 voting members with one vote for every unit they own, and each voting partner
12 participates in the control, management, and direction of the GP. (*Id.* ¶ 5.1.1.)

13 All voting members of the partnerships have the ability to engage and control
14 the partnerships however they wish. (*Id.* ¶ 5.2) All partnership decisions must be
15 made by a majority vote, including decisions to admit new partners, to amend the
16 partnership, or to terminate the partnership. (*Id.* at ¶¶ 5.1.2, 4.5, 11.17, 9.1.) Any
17 partner may request a vote of the general partnership at any time concerning any
18 matter "relevant to the business and operations" of the partnership. (*Id.* at 5.2.2.)
19 Partners may initiate a ballot for partnership vote simply by submitting a request to
20 the partnership secretary, who has no discretion over such requests and simply
21 serves as a messenger coordinating distribution of ballots to all other partners.

22 Neither Western nor Schooler has any authority or control over the
23 management of the GPs; when either purchases units in a GP, the general
24 partnership agreement specifically provides that Western and Schooler (and their
25 affiliates) cannot vote on any general partnership matters. (*Id.* at 5.1.3.) They are
26 non-voting members only. (Dkt. No. 3-1, at 4, n. 3.)

27 The only ongoing management required of the partnerships is payment of
28 property taxes and insurance, along with filing K-1s. Schooler Decl., § 8. To handle

1 some of the administrative matters, the GPs appoint a partnership administrator,
2 who maintains a GP mailing address, records, and bank accounts, prepares and
3 distributes correspondence to general partners, and other administrative tasks on
4 behalf of the GP. (Ex. 1, ¶ 7.1.) The partnership administrator has no discretion or
5 control over any GP decisions. The GPs also appoint a signatory partner; however,
6 the signatory partner only serves to sign documents on behalf of the GP when
7 authorized to do so by the partnership agreement or by a partnership vote. (*Id.* ¶
8 4.2.) Some have tried to characterize the signatory partner as a managing partner,
9 but that is not accurate. The signatory partner simply serves as a party authorized to
10 execute authorized documents on behalf of the partnership, but has no discretion or
11 authority to take any action beyond that specifically authorized by the partnership
12 agreement or a partnership vote. (*Id.* ¶ 4.2)
13 In addition to the General Partnership Agreement, investors review and sign
14 the Partner Representations (*See* Partner Representations of P-40 Warhawk Partners,
15 attached hereto as Exhibit 2) setting forth additional detailed disclosures regarding
16 the structure of the investment. Investors acknowledge in writing that they
17 understand the investment is in raw land, that the investment is speculative and high
18 risk, with an unknown duration and an unknown return on the investment, including
19 the possibility that that they may lose their entire investment. (*Id.* at §§ 6, 14, 16.)
20 The Partner Representations also explain that the sale of the land from Western to
21 the GP is an arms-length transaction, that Western makes a "very substantial" profit
22 on the sale of the land to the GP, and that, therefore, as between Western and the GP
23 there is a direct conflict of interest and no fiduciary duty owed. (*Id.* at § 74).
24 During Western's history, some of the land acquired by Western or its
25 subsidiaries has been purchased with financing extended by the party originally
26 selling the parcel(s) to Western. During the 35 years of Western's operations,
27 Western has never defaulted on repayment of any original seller financing on the
28 parcel(s) sold to the GPs.

Dozens of GPs have operated independently under this system for several decades, and those who have sold property have experienced a profit.

B. Procedural Status of Receivership

The SEC brought its Complaint against Defendants on the grounds that the GPs are "securities." As part of these proceedings, the SEC sought an order from the court appointing a receiver for Western and the GPs, first as part of the SEC's proposed TRO and then as part of the preliminary injunction.

On September 6, 2012, the Court appointed Thomas C. Hebrank as temporary receiver "of Western and the entities it controls," including approximately 86 general partnerships. (Dkt. No. 10, 10-1.) The Court then reaffirmed the receivership in its order of October 5, 2012, granting the conversion of the TRO into a preliminary injunction. Dkt. No. 44. On November 30, 2012, the Court in its Order Re: Receiver's Second Report and Proposal continued the receivership in effect because while there "may be no need for a receiver to marshal and preserve assets from misappropriation and dissipation," the receivership "over Western is needed to clarify Western's financial affairs." Dkt. No. 59, p. 9, ll. 26-27, and p. 10, ll. 17-18. The Court issued a final Preliminary Injunction and order appointing a permanent receiver on March 13, 2013, with the receivership continuing in effect. Dkt. No. 174.

III.

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." *S.E.C. v. Hardy*, 803 F.2d 1034, 1037 (9th Cir. 1986); *see also S.E.C. v. Lincoln Thrift Ass'n*, 577 F.2d 600 (9th Cir. 1978) (district court has "wide discretion to determine the appropriate relief in an equity receivership"). However, "[a] receivership is only a means to reach some legitimate end sought through the exercise of the court of equity. It is not an end in itself." *Kelleam v. Maryland Cas.*

Co., 312 U.S. 377, 381 (1941) (emphasis added) (quoting *Gordon v. Washington*, 295 U.S. 30, 37 (1935)). "Consequently, a receivership must be monitored to ensure it is still serving the function for which it was created." *S.E.C. v. Madison Real Estate Group, LLC*, 647 F. Supp. 2d 1271, 1275 (D. Utah 2009) (citing *Gordon*, 295 U.S. at 37).

The receivership in this matter should be modified to exclude the GPs. Besides the fact that there has been adequate opportunity for the Receiver to clarify Western's financial affairs, which the Court found as the main purpose of the receivership, the GPs are independent entities, completely separate from the Defendants in this litigation, and there is no basis to stretch the Receiver's control beyond Western and over the GPs as well. 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. 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. That is particularly true here, where the Commission has yet to prove its allegations concerning Western at trial, and where the GPs have not been granted their due process right to a hearing about whether their assets should be part of the receivership estate in the first place.

A. There Is No Basis For Including The General Partnerships In The Receivership Estate.

The SEC's entire basis for asking that the GPs be included in the receivership is the false notion that Western somehow "controls the GPs." (Dkt. No. 3-1 at 22.) But Western does not "control" the GPs. The general partnership agreements make it clear that *only* the members of the general partnership 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. (Ex. 1, ¶ 5.1.1.)

1 The general partnership agreement specifically provides that Western is unable to
2 vote on any general partnership matters. (*Id.* ¶ 5.1.3; Dkt. No. 3-1 at 4, n. 3.)
3 The receivership should not include the GPs because, as even the SEC
4 acknowledges, "the GPs are separate entities from Western." (Dkt. No. 3-1 at 23.)
5 Neither the Receiver nor the SEC can exercise rights concerning assets that
6 Defendants do not own and do not control. *Javitch v. First Union Sec.*, 315 F.3d
7 619, 625 (6th Cir. 2003) ("the general rule is that a receiver acquires no greater
8 rights in property than the debtor had and, except for liens in existence at the time of
9 the appointment, the receiver holds the property for the benefit of the general
10 creditors under the directions of the court") (citations omitted); *Markos v. Schechter*,
11 182 B.R. 211, 217 (N.D. Ill. 1995) ("The situation in which trustees have been most
12 commonly found to have acted outside their authority is in seizing property which is
13 found not to be property of the estate.").
14 The SEC cites case law for the proposition that "the property of a non-party
15 *limited partnership*" may be included in a receivership estate. (Dkt. No. 3-1, at 23
16 (emphasis added).) But that has no applicability here. In *In re San Vicente Medical*
17 *Partners Ltd.*, 962 F.2d 1402 (9th Cir. 1992), cited by the SEC, a receivership had
18 been imposed on a defendant and the evidence was undisputed that the defendant
19 served as the managing partner of a limited partnership – a position of clear control
20 with regard to that limited partnership. There is no analogy to be drawn from *San*
21 *Vicente* to the present case. Western holding a small minority position of non-
22 voting units in *a general partnership* is simply a wholly different situation than the
23 defendant in *San Vicente* that served as the managing partner of a *limited*
24 *partnership.* In *San Vicente* the receiver was assuming powers it was clear the
25 defendant in that case had. Here, by contrast, the Receiver cannot assume powers
26 that Defendants never had, including the ability to decide unilaterally when the
27 partnerships should appraise or liquidate assets. Only the GPs have that ability.
28 Keeping the GPs in the receivership estate serves no beneficial purpose and

1 actually has a direct harm on the parties the SEC purports to be helping: the investor
2 general partners. The Receiver claims to be "protecting and maximizing the GPs
3 assets for the benefit of investors" and proposes eventually to make
4 recommendations regarding the disposition of GP assets. (Dkt. No. 49, at 3-4, 11).
5 However, rather than empowering or protecting the investors, the general partners
6 forfeit to the Receiver any ability they have to make GP decisions. Until the
7 resolution of this matter, the Receiver could decide to sell assets at any time, likely
8 forcing the investing general partners to take an unnecessary loss. That is
9 particularly unfair when the SEC has not yet proved at trial that Defendants violated
10 any securities laws. Regardless, neither the SEC nor the Receiver has provided any
11 evidence showing that the GPs are incapable of governing themselves or deciding
12 the appropriate time to sell their assets.

13 The SEC and Receiver further argue that the GPs should be included in the
14 receivership to protect them from Western's possible financial failure. But the
15 financial health and future of Western has *no impact* on the financial health and
16 future of the GPs. The GPs own title to land. The return on their investment
17 continues to turn on the same factors that existed the day they entered into the
18 investment: when will a party be interested in purchasing the property from the GP
19 and at what price?

20 Those are the same factors that have generated profits for past GPs and there
21 is nothing about the present litigation that alters that reality. There is nothing that
22 needs to be done to maintain title to the property and eventually sell to another party
23 that cannot be ably handled by the GPs who don't need the costly assistance of a
24 receiver and receiver's counsel.

25 The investors include people from all walks of life, including CEOs and
26 CFOs of companies, real estate developers, engineers, scientists, attorneys,
27 accountants, real estate brokers, and many other professionals fully capable of
28 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.

The Receiver has recently pointed to the possibility of Western defaulting on notes Western owes to the parties that originally sold the property to Western. The Receiver mistakenly believes that a default by Western on those underlying notes would create a foreclosure risk for the GPs. This concern is easily rebutted.

First, Western has never defaulted on a single underlying note in its history.

Second, in every discussion about the underlying notes, the Receiver leaves out of the discussion the fact that for every dollar Western owes on an underlying note, more than a dollar is owed to Western by the GPs on the notes the GPs execute at the time of purchase of their title from Western. Even more notably absent from the Receiver's discussion of the underlying notes is the fact that Western is owed by the GPs $1.5 million more than Western owes on the underlying notes. There are sufficient funds, and a simple automatic payment plan could be set up that would ensure there was never a default on any of the underlying notes, many of which retire over the course of the next few years (some as soon as six months from now).

Third, as a belt and suspenders provision, the notes between Western and the GPs are secured by a deed providing specifically that should Western fail to make its payment to the original seller (an event that has never occurred), the obligation of the GP to make its payment to Western is immediately suspended. The GP then makes its payment directly to the original seller. The inability of Western to satisfy any obligations would therefore have no impact on the GPs, who would immediately begin to make direct payments to the seller -- in essence, not changing any payment obligations that the GPs currently have.

Fourth, the obligation on the underlying note is one owed by Western, not the GPs, so even if this was an appropriate concern, its remedy in no way requires the GPs to be part of any receivership.

Try as they might, the SEC and Receiver cannot identify any rational basis for the GPs' assets to continue to be part of the receivership.

B. The GPs Are Not Defendants' Alter Ego.

The SEC alternatively suggests that even if the GPs are not controlled by Western, the Court should "pierce the corporate veil," "disregard corporate formalities," and conclude that the GPs and Western are essentially the same entity, thereby allowing the GPs' assets to be included within the receivership. (Dkt. No. 3-1 at 23-24.) Yet the SEC provides not a single bit of evidence supporting this theory. The SEC cites several Ninth Circuit district court cases listing factors that courts consider when analyzing whether the corporate veil should be pierced, including the comingling of funds; unauthorized diversion of funds or assets to other than corporate purposes; identity of equitable ownership in the two entities; failure to observe corporate formalities; nonpayment of dividends; the siphoning of funds of the corporation by the dominant stockholder; nonfunctioning of other officers or directors; absence of corporate records; and the fact that the corporation is merely a facade for the operations of the dominant stockholder. (Dkt. No. 3-1 at 23-24; *S.E.C. v. Elmas Trading Corp.,* 620 F.Supp. 231, 234 (D. Nev. 1985).)

None of those factors apply here, nor does the SEC allege otherwise. There is no allegation that corporate forms have been disregarded, or that the formation of the GPs was some kind of sham. As discussed, there is no overlap in management or control between Western and the GPs: Western has no greater ability to manage the affairs of the GPs than any of the other general partners, and in fact is a non-voting member of any GPs in which it owns units. Western observes its own corporate practices, which are distinct from the practices of the GPs.

Perhaps most importantly, there is absolutely no evidence of Western's "siphoning" assets from the GPs. To the contrary, as the Receiver and the SEC have consistently acknowledged in this litigation, Western relies principally on capital contributions from *Schooler*, not from the GPs. (*See, e.g.,* Dkt. No. 49, at 2-3.)

C. The GPs Are Entitled To A Pre-Receivership Hearing.

When a receiver is appointed over assets that are disputed by a third party, due process dictates that the third party be given a hearing on the matter. (*Liberte Capital Group, LLC v. Capwill*, 421 F.3d 377, 384 (6th Cir. 2005) (quoting *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 569-70 (1972) ("When protected interests are implicated, the right to some kind of prior hearing is paramount.") (other citations omitted).)

When it requested its temporary restraining order, even the SEC recognized that the "GPs *will* ... 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 at 23 (emphasis added) (citing *In re San Vicente Med. Partners Ltd.*, 962 F.2d 1402, 1408 (9th Cir. 1992) ("a district court has the power to include the property of a non-party limited partnership in an SEC receivership order as long as the non-party meets the minimum contact standard ... and receives actual notice *and an opportunity for a hearing*") (emphasis added).)

As the Court has recognized, many of the investors affected here have challenged having their assets placed in the receivership by submitting communications to the Court. (*See* Dkt. No. 169 at 3-5.) Those investors should be given the opportunity to provide further considerations directly before the Court. See *Liberte Capital Group, LLC v. Capwill*, 421 F.3d 377 384 (6th Cir. 2005) (district court improperly denied a hearing to determine claimant's ownership).

D. The Receiver's Operations Are Inappropriate and Unnecessary For Enterprises Involving Ownership and Management of Raw Land Held for Future Appreciation

Typically, a court appoints receivers to operate or manage an activity involving real property when the property is being mismanaged to the point 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

1 activity, namely the mere payment of property taxes and insurance and the
2 preparation of annual income tax forms for the partners, there is no opportunity for
3 managerial shenanigans that would justify the appointment of a receiver.

4 The securities-fraud cases invoked by the SEC in its memorandum of points
5 and authorities in support of its TRO application (Dkt. No. 3-1) were complex
6 business activities that had a real-estate component. The cited cases typically
7 involved improved property such as orange groves (*SEC v. W.J. Howey Co.*, 328
8 U.S. 293 (1946)), jojoba farms (*Koch v. Hankins*, 928 F.2d 1471 (9th Cir. 1991)),
9 and apartment buildings (*McConnell v. Frank Howard Allen & Co.*, 574 F.Supp.
10 781 (N.D. Cal. 1983)). In those cases, there was an active business enterprise that
11 took place on a piece of real estate, which is markedly distinct from simply owning
12 the undeveloped real estate and leaving it alone to appreciate in value as
13 neighboring properties are developed (as in this case).

14 In contrast to the situations in *Howey, Koch, and McConnell*, where
15 mismanagement of the day-to-day business operations could have ruined the
16 investments, the GPs in this case were established solely for investment in raw land
17 that would be held for the long term, until such time as the surrounding area had
18 developed. Schooler Decl., § 7. The GPs were not organized to perform the
19 business activities required for eventual development of the land, such as applying
20 for land-use entitlements, or installing the necessary infrastructure such as roads,
21 water and sewer mains, and electricity. Schooler Decl., § 7. Those complex
22 activities would be done by the developers after they had bought the land from the
23 GPs. The defined purpose, as presented in the partnership agreements and Partner's
24 Representations, was for the GPs to hold the land until, in the general partners'
25 opinion, the time was right to sell – that is, when the developers needed the land for
26 their residential neighborhoods, shopping centers, or industrial parks. The only
27 decision to be made is whether to accept an offer to purchase the land held by the
28 enterprise.

1 For all of the GPs, the operational requirements are minimal to the point of
2 being merely administrative: pay the property taxes and insurance, and ensure that
3 the partners receive their Form K-1's in time for preparing their tax returns.
4 Schooler Decl., § 8.

5 Installing a receiver into a system that has functioned without incident for
6 over three decades harms the GP's in two ways. First, the receivership removes
7 control of the land from its owners, the investor-partners who are the sole
8 beneficiaries of their ownership decisions. Second, the cost of the receivership,
9 including legal fees and consultant/expert fees, is an expense that was never
10 anticipated by anyone involved, certainly not the investors.

11 As Defendants have previously explained at length (including, *inter alia*, Dkt.
12 Nos. 14, 21 and 43-1), the SEC's position, upon which this Court appointed the
13 Receiver, is based on a fundamental misunderstanding of how the GPs are organized
14 and operated. Under the terms of the partnership agreements, the GP investors retain
15 full control and all major decisions require a majority vote, with Defendants having
16 only a non-voting interest. (Ex. 1 . ¶ ¶ 5.1.3. and 5.2) Defendants share in the
17 profits of the eventual resale of the raw land to developers, but they do not get to
18 control when the land is to be sold, to whom, and for how much, because of their
19 complete lack of control through voting. The GP investors, by virtue of retaining
20 control by majority vote, are true general partners, not disguised limited partners.

21 Furthermore, the GP investors acknowledge in the "Partner's
22 Representations" (Exhibit 2) that they have read the summaries of the engineering
23 reports, that the investment is speculative, that the complete loss of their investments
24 is possible, and that they are not relying on any representations by Schooler or
25 Western as to the present or potential value of the land that the particular GPs are to
26 acquire. (*Id.* at § 6, 19, 37). The GP investors also acknowledge in the Partner's
27 Representations that there is no fiduciary relationship between Defendants and the
28 investors. (*Id.* at § 74.) Therefore, the GP investors acknowledge that their interests

1 are separate from Schooler's and Western's, which further demonstrate a lack of
2 control on Schooler's or Western's part over the GPs.
3 The SEC does not claim that the partnership agreements are void or voidable,
4 or that the GPs are not legally established entities, or that the GPs are not record
5 owners of the properties that the GP investor-partners have invested in.

6 **E. The Receiver Has Endorsed the Integrity of the Accounting Records**
7 **for Both Western and the GPs**

8 In his recently filed Receiver's Forensic Accounting Report: Part One (Dkt.
9 No. 182) filed on April 18, 2013, the Receiver performed a series of tests on the
10 "OPADS Accounting System and other data maintained by Western." (*Id.* at 14.)
11 The Receiver's conclusion was that the accounting records for Western and the GPs
12 were "accurate and reliable."
13 After nine months of forensic sleuthing, with full and complete access to
14 every single document, record, data system, program, and records of both Western
15 and the GPs, the Receiver has not identified any operational malfeasance or
16 financial mismanagement. The dollars are accounted for. The transactions are what
17 they purport to be. Noticeably absent are any of the accounting issues one normally
18 reads about in cases of investment fraud.
19 The only fraud allegation made to date is with regard to the pricing of the
20 units. There is nothing the Receiver can do at this point with regard to that alleged
21 activity. There simply is no evidence or even any allegation regarding ongoing
22 operational malfeasance or financial mismanagement of the GPs requiring the
23 protection of a Receiver. In other words, there is no ongoing purpose served by the
24 Receiver to justify the additional direct cost to the investors.

25 **F. The Receivership Has Not Operated to Preserve the GP's, But Instead**
26 **Is Seeking to Liquidate Them**

27 A receiver appointed by a federal court must manage and operate the property
28 in receivership "according to the requirements of the valid laws of the State in which

such property is located, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." 28 U.S.C. § 959(b).

As court-appointed officers, receivers are to act within the scope set by the court. See *Warfield v. Alaniz*, 453 F. Supp. 2d 1118, 1132 (D. Ariz. 2006) (court-appointed-receiver in action brought by SEC "an officer of the court") (citing *In re San Vicente Med. Partners, Ltd.,* 962 F.2d 1402, 1409 (9th Cir. 1992)). However, "a court will not be justified, through the medium of a receiver, in arbitrarily withholding property from the owner's control and enjoyment for an indefinite and unnecessary period." *Fairbank v. Sup. Ct.*, 34 Cal.App. 66, 73 (1917).

Notwithstanding the case law regarding the role of a receiver, the Receiver in this case is not acting to preserve the GP property as a Receiver is required to do with going concerns; rather he is jumping ahead to his own conclusion, contrary to all evidence, that he is supposed to act as a liquidating trustee. The purpose of the original investment was to hold the investment until development reaches the property, allowing for a significant return on the investment. That purpose is still fully intact.

For the Receiver to unilaterally decide without any investor input to spend the investors' money on appraisals at a time when the market is at an all-time historic low is not in the investors' best interest. The paper value of a raw land investment in a stagnant market is not informative. Even if one were to recognize the value ascribed by an appraiser, that does not put any dollars in the investors' pockets, but rather takes money out of the investors' pockets to pay for the appraisal.

The return on the investment still depends upon a buyer interested in buying the property. No appraisal can create a buyer that does not exist right now.

The Receiver never even paused to see if this is an exercise the investors wanted to spend their money on. If the investors want to have an appraisal done, then by all means – the voting members have that ability to take that action on their own without needing a Receiver to do so. And more importantly, it should be the

investors who should be given an opportunity to decide how they want their resources used.

The Receiver has stated in his Fourth Interim Report that the appraisals will be reported to the Court together with the Receiver's recommendations regarding disposition of the properties. It is inconceivable how the Receiver can arrive at a final conclusion regarding disposition of the GPs' real estate without having taken any steps to gather the sentiments of the very people he is purportedly protecting.

The GPs have the ability through their majority rule ballot process to change direction and make any decision a majority of voting investors want to make at any point in time. The investors have that autonomy. But for the Receiver to unilaterally take the investment in a completely new and costly direction without the investors having any such input is unconscionable.

IV.
CONCLUSION

Based on the foregoing, Defendants respectfully request that this Court modify the preliminary injunction order and remove all the real estate general partnerships from the receivership in this matter.

DATE: May 29, 2013

Respectfully submitted,

____/s/Eric J. Hougen___________________

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CERTIFICATION

I hereby certify that on the 29th day of May 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 counsels of record:

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