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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' REPLY TO THE RECEIVER'S AND SECURITIES AND EXCHANGE COMMISSION'S OPPOSITIONS TO MOTION FOR MODIFICATION OF THE PRELIMINARY INJUNCTION ORDER TO REMOVE THE REAL ESTATE GENERAL PARTNERSHIPS FROM THE RECEIVERSHIP

Date: July 26, 2013
Time: 1:30 p.m.
Ctrm: 2D
Judge: Hon. Gonzalo P. Curiel

NO ORAL ARGUMENT UNLESS REQUESTED BY THE COURT

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Defendants LOUIS V. SCHOOLER ("Schooler") and FIRST FINANCIAL PLANNING CORPORATION d/b/a WESTERN FINANCIAL PLANNING CORPORATION ("Western") (collectively "Defendants") hereby submit the following reply to the oppositions of Thomas C. Hebrank ("Receiver") and the Securities and Exchange Commission ("SEC") to Defendants' Motion for Modification of the Preliminary Injunction Order to Remove the Real Estate General Partnerships from the Receivership (Dkt. No. 195, "Motion").

I.

INTRODUCTION

From the beginning of this litigation, the SEC and the Receiver have claimed to be acting in the best interests of investors in the real estate general partnerships ("GPs"), and yet their oppositions to Defendants' Motion reveals a complete disregard for those interests. In their briefs, the SEC and Receiver argue against giving the investors their due process right to a hearing on whether their assets can properly be included in the receivership, a right long recognized in the case law. Even worse, they wholeheartedly endorse a scheme that would liquidate GP properties at fire-sale prices, long before any of the claims and allegations in this matter have been resolved at trial – and without any meaningful input from investors.

While revealing their lack of support for the investors, the SEC and Receiver never get around to rebutting the fundamental reasons why the GPs should be removed from the receivership: that the GPs (1) are separate entities that operate independently of Defendants, (2) are not accused of any wrongdoing, and (3) are perfectly capable of operating without the Receiver's costly, redundant, and unnecessary oversight (a point directly conceded by the Receiver in its Report on Appraisals (Dkt. 203 at p. 2)). Instead of addressing these central points, the SEC and Receiver focus on a number of peripheral, irrelevant issues, none of which provides any basis for continuing the receivership over the GPs.

The SEC and Receiver's arguments fail for several reasons:

First, in a direct retreat from its earlier position, the SEC now claims there is no need to protect the investors' due process rights through a hearing, and instead tries to convert letters submitted by some of the investors into the equivalent of a hearing before the court. The SEC fails to explain how letters sent to the Court ***after*** the permanent receiver was already appointed can serve as the equivalent of the hearing that due process requires to happen ***before*** a permanent receiver can lawfully be appointed over an entity's assets. The case law, as the SEC previously recognized, is clear that before the investors' property can be controlled (much less liquidated) by a court-appointed receivership, they are entitled to, at the very least, a full hearing before this Court. The SEC's disingenuous and desperate suggestion that *Defendants* are somehow responsible for the investors' never getting their day in court should be ignored. The GPs have simply not been given a hearing. Either the GPs should be afforded a hearing, or their property should be released from the receivership.

Second, the SEC and Receiver list a handful of purely administrative tasks purporting to demonstrate that Defendants somehow control or manage the GPs, and therefore the GPs are incapable of operating without a receiver. To begin with, this contention is completely undone by the Receiver's own filing stating that he sees "no reason why a group of GPs that collectively own a property ... should not be able to retain the property and take sole responsibility for all mortgages and expenses associated with the property." (Dkt. 203 at p. 2). More importantly, none of these tasks amount to "control" or "management." The tasks identified by the SEC and Receiver are purely administrative tasks and are simply not enough to make a limited partnership out of the relationship that exists between Western and the GPs. In fact, the administrative functions are not even carried out by Western. They are carried out by independent contractor partnership secretaries that can be fired and replaced at will by the GPs. Once the GPs are formed, there is no role for

1 Western in the ongoing administration and operation of the GPs – they are separate
2 and independent from Western.

3 The SEC is not able to change the basic facts of this case that the GPs are
4 true general partnerships in which all investors not affiliated with Western have a
5 direct vote on all essential matters. To the extent Defendants hold any units in any
6 GPs, they hold them as non-voting members. The GPs are independent entities
7 that have always had complete control over their investments, including the ability
8 to fire and hire the partnership administrators and to make their own decisions on
9 when to sell their property. Ironically it is only now -- while they are under the
10 thumb of the Receiver -- that they are in danger of losing these powers.

11 Third, the SEC and Receiver resort to complaining that the Motion is
12 untimely and that Defendants stipulated to the receivership. These second-string
13 arguments come up short. This Court has broad authority to fashion an equity
14 receivership to fit the needs of the case, and that authority can be exercised at any
15 time and without a request by any party; that authority would be appropriately
16 exercised in a case such as this one where the GPs are fully capable of paying their
17 own taxes and insurance and tending to their other minimal administrative needs,
18 and where the Receiver is proposing a liquidation of GP assets that has no basis in
19 the law or this Court's direction.

20 Fourth, the SEC and Receiver provide no credible explanation for how the
21 receivership helps the investors preserve their assets, or why his involvement is
22 needed when the threat of malfeasance or misappropriation has been shown not to
23 exist. More than ten months of forensic review has resulted in the Receiver
24 endorsing the accounting records of both Western and the GPs as "accurate and
25 reliable." There have been no reports of missing funds, unaccounted for
26 transactions, altered books and records, or other malfeasance or mismanagement
27 normally associated with fraudulent activity. The Receiver has even endorsed all
28 of the personnel who have been handling the books, records, and transactions for

more than three decades, hiring them and relying on them to carry out the same functions they always have.

Finally, the Receiver argues that he seeks to "save" the GPs from "the risk of losing properties via foreclosure," and yet he has proposed a scheme under which the investors would have to take extraordinary action and swallow numerous poison pills just to avoid sales that would essentially amount to foreclosures; in essence, he proposes to destroy the GPs in order to save them. There is no need for the GPs to be in *any* receivership -- much less that kind of receivership -- and they should therefore be removed from it.

II.

ARGUMENT

A. The GPs Have a Due Process Right to a Hearing If Their Assets Are To Continue To Be Controlled By The Receiver

For an entity purporting to be "a statutory guardian ... safeguarding the public interest,"[1] the SEC demonstrates a surprising lack of regard for that public's due process rights. The SEC and the Receiver (who does not even discuss the issue in his opposition) seem to fear the prospect of giving investors their rightful opportunity to appear before this Court and argue against having their assets controlled almost entirely by a third party when they have never been accused of any wrongdoing. Instead, the SEC and Receiver treat the judicial process as an inconvenience, essentially acting as judge, jury, and enforcer of a result that has yet to be proven at trial.

Both ignore the well-established law in the Ninth Circuit and elsewhere making it crystal clear that before a third party's property can be included in a receivership -- much less liquidated by that receiver in a manufactured "opt-out only" regime -- the party is entitled to a *formal hearing* before the court, as the

[1] *See* SEC's Opposition to Emergency Motion to Dissolve or Modify Temporary Restraining Order (Dkt. 18) at 3 (citations and quotations to case law omitted).

1 SEC even acknowledged (and promised) at the beginning of this litigation. (Dkt.
2 No. 3-1, p. 31 of 33 ("a district court has the power to include the property of a
3 non-party limited partnership in an SEC receivership order *as long as* the non-
4 party meets the minimum contact standard ... and receives actual notice and an
5 opportunity *for a hearing*" (*quoting In re San Vicente Med. Partners Ltd.*, 962 F.2d
6 1402, 1408 (9th Cir. 1992) (emphasis added); *see San Vicente*, 962 F. 2d at 1407
7 ("The Constitution *requires* that property owners receive procedural due process in
8 the form of notice and opportunity *for a hearing.*") (emphasis added) (*citing Goss*
9 *v. Lopez*, 419 U.S. 565, 577-79 (1975) ("deprivation of life, liberty, or property by
10 adjudication [must] be preceded by notice and *opportunity for hearing* appropriate
11 to the nature of the case") (emphasis added, citations and quotations omitted)[2].)
12 The investors here have never received that minimal due process protection
13 during the entire ten-month period their assets have been placed in receivership.
14 The SEC attempts to camouflage that deficiency by suggesting that investors have
15 "actively participated" in the proceedings by submitting some letters to the Court.
16 (Dkt. No. 207 ("SEC Opp.") at 6.) This reliance by the SEC on investor letters is
17 both confounding and telling. As the SEC pointed out in its original *ex parte* TRO
18 application: "The GPs will then have notice and an opportunity to be heard ***before***
19 any of their assets are placed under the control of a permanent receiver." (Dkt. #3-
20 1 at p. 31 of 33) (emphasis added). The SEC does not explain how letters written
21 to the court ***after*** the permanent receiver had already been appointed and incurred
22 fees can be used as a replacement for the hearing that due process requires to be
23 held ***before*** appointment of a permanent receiver over third-party assets. *All* the
24 investors are entitled to an opportunity to appear before this Court and hear a
25
26 [2] *C.f., U.S. v. Arizona Fuels*, 739 F.2d 455, 459 (9th Cir. 1984) (non-party received due
27 process in receivership proceeding since they were involved in multiple steps, including
appearance of their attorney at preliminary injunction hearing); *S.E.C. v. Whitworth Energy*
28 *Resources Ltd.,* 243 F.3d 549 (9th Cir. 2000) (investors' procedural due process rights protected
when given an opportunity for a hearing concerning the sale of property in receivership).

detailed explanation for why their assets belong in receivership and specifics about the receivership's powers, scope, and duration, among other details. They also should be afforded the opportunity to rebut the SEC's and Receiver's arguments, with the assistance of counsel should they choose.

The SEC and Receiver never provide a good reason why they do not want the investors to be heard on these important matters. Instead, in an astonishing display of hypocrisy, the SEC attempts to portray the *Defendants* as having opposed the GPs' right to due process. The SEC distorts arguments made by Defendants in a much different context, in the days following the SEC's sneak-attack request for a temporary restraining order. At that point, Defendants had not had any opportunity to respond to the SEC's allegations of fraud, which were hours away from being circulated among the investors. *The Court agreed with Defendants on this point* and struck the fraud language from the notice to investors, stating that the Court's imprimatur should not be placed on the SEC's fraud allegations. (*See* Preliminary Injunction Order (Dkt. 44) at 24-25.) The SEC itself is being "disingenuous" by characterizing Defendants' response to its midnight raid on Defendants' and investors' assets as an attempt to "prevent" the investors from being heard.

Defendants have not acted to "block" any participation by investors. Indeed, Defendants are the only party doing everything they can to protect investor rights and to *encourage* the investors' participation. If the SEC and Receiver's allegations and arguments are really as strong as they suggest they are, then rather than trying to silence the GPs' voices, the SEC and Receiver should join Defendants and invite the investors to participate in the proceedings.

B. The GPs Are Independent Entities That Do Not "Depend On" Defendants And Do Not Need The Receiver's Protection

Neither the SEC nor the Receiver ever squarely addresses the principal argument for separating the GPs from the scope of the receivership here: that the

GPs are completely separate, independent entities that are not alleged to have conducted any fraudulent activity and have no business being under the control of a Receiver who proposes to sell them off at historically low prices.

Instead, they both mischaracterize the GPs' relationship with Defendants as a limited partnership, with the GPs "dependent" on Western's "management," and therefore in need of the Receiver's "management." Yet neither can point to a single action that demonstrates Western's management or discretion over the GPs' business, which involves solely buying and holding raw land until they vote to sell it. According to the SEC and Receiver, Defendants' "management" over the GPs consisted of: (1) paying mortgage fees for the GPs' properties; (2) conducting "administrative tasks" and acting as contact points for investors seeking information regarding their particular GPs; (3) making loans to certain GPs to cover operating expenses; and (4) repurchasing units from certain investors. (*See* SEC Opp. at 3-5; Dkt. No. 206 ("Receiver Resp.") at 3.) As the SEC acknowledges, the Receiver has simply taken over Western's limited role and "overseen administrative tasks on behalf of the GPs, such as filing of their taxes and acting as a point of contact for investors seeking information regarding their investments."[3] None of these purely administrative activities rises to the level of discretion, authority, or control over the GPs, who have always operated independently from Defendants.

Even the Receiver admits that the "GPs may be able to hire somebody to perform some of these functions performed by Western (and possibly survive without others)" (Receiver Resp. at 3). Indeed, the GPs have *always* had that

[3] Moreover, it appears that the Receiver has not even performed this minimal task well, since a number of investors have reported that he does not respond to their questions and concerns. See, e.g., Dkt. No. 168, letter from Yi Weng: ("The Receiver has certainly been neither open nor helpful to the investors, denying access to one-on-one meeting with him to help us understand what and why he is doing things."); Dkt. No. 165, letter from Usha Christi ("Since I first got the notice of receivership I have sen[t] emails to find out information and I only got a standard answer to visit their website.").

ability. The partnership agreements allow the GPs, by a simple majority vote, to terminate the GP administrator and replace it with another of their choosing. (*See* Dkt. 195-3 (Statement and Agreement of Partnership of P-40 Warhawk Partners) at 12, ¶ 7.1.4 (allowing termination of Partnership Administrator by majority vote, with or without cause).)

Contrary to the Receiver's assertions, it is not even Western who carries out the administrative functions. It is an independent contractor partnership secretary that serves this function. While Western plays an important role in forming the GPs, once formed there is no role for Western in the ongoing administration and operation of the GPs. Everything is handled by the partnership secretaries.

Perhaps recognizing the deficiency in its arguments that Defendants "control" the GPs, the SEC manufactures out of thin air the purported ability of Schooler to "find purchasers for the GPs' land and negotiate the terms of the sale." (SEC Opp. at 3.) The SEC supports this fiction by quoting from a single investor letter (which, ironically, it later dismisses, along with all the other investor letters); it has not produced a single relevant document proving that Schooler has the power or obligation to "manage" the decision of when to sell GP properties, or for how much. The SEC and the Receiver simply ignore the fact that neither Western nor Schooler can vote on when to sell property or any other GP decision. Even worse, the SEC and the Receiver also ignore the relevant documents in awarding the Receiver the power to force a sale of the GPs' property absent a vote to split from the receivership, a power that no entity, including Defendants, has ever had.

As a backup plan (a plan that fares no better than the original plan), the SEC also invents an alter ego relationship between Western and GPs, relying entirely on the allegation that Western ignored corporate formalities by purportedly using GP funds to pay Western costs and expenses "during the interim" before a GP property closed. That is simply false. The funds in question are the funds paid by the GPs to Western pursuant to the sale/purchase agreement by which Western sold its title

in a subject property to the respective GPs. The funds passed from the GPs to Western in exchange for title.

Contrary to the SEC allegations, the offering documents – and specifically, the Partner Representations - clearly stated that investor funds contributed to the investment would be deposited into the GP's account, and then that portion of the funds attributable to the purchase of the title from Western (usually approximately 93% of an investors' total investment amount) would immediately pass to Western as the seller of title. (Dkt. No. 195-4, p. 2 of 13, ¶ 12.) The other approximately 7% of funds invested was allocated to the GPs' operating capital – this was the portion of the capital invested that truly belonged to the GPs (as opposed to the 93% that was allocated for purchase of title from Western).

The funds belonging to the GPs (the 7% designated for operating capital) always stayed in the respective GPs' accounts and were never accessed by Western. (*Id.* at ¶ 12). The only portion that passed directly to Western from the GPs was the portion allocated to the purchase of the land. It was fully disclosed to investors in the offering documents that the purchase portion of the investment amount would immediately pass to the seller in exchange for the GPs' right to receive title from Western. Therefore, there is no unauthorized use of funds.

In the long history of Western, title has in every instance passed from Western to the GPs as soon as each GP was fully formed.[4] Just because the SEC may be more familiar with the use of escrow accounts to hold purchase funds prior to close of a sale/purchase transaction, the lack of an escrow account does not create an alter ego relationship – especially when the structure of these transactions, including the immediate payment of purchase funds to the seller, was fully disclosed to investors ahead of their investment. While creative on the part of

[4] There was one GP that had not yet closed when the Receiver was appointed, however, contrary to the SEC's allegations, that GP holds a right to title of its subject property – all that is needed is for that GP to close and for title to be conveyed to the GP. Normally this would be done when the GP is fully subscribed.

the SEC, this allegation is hollow.

Try as they might, the SEC and the Receiver have not produced any credible evidence that Defendants are anything other than what they always have been: syndicators of land deals, then *passive, non-voting investors* in those same raw land deals. The SEC is left with only a handful of basic administrative functions (paying property taxes, insurance, and engaging an accountant to prepare Form K-1's) that it desperately tries to elevate to the level of "management", "discretion", or "authority" – all in the name of trying to turn the GPs into limited partnerships. The SEC strongly relies on the *San Vicente* case for the proposition that the GPs are under the control of Western, but *San Vicente* is completely inapplicable: in that case, there was no dispute and the formation documents clearly identified the defendants as the managing partners with broad discretion and authority over various limited partnerships – none of which is present here.

Add the fact that the GPs can fire and hire their partnership administrators at will (a factor relied upon heavily by the Ninth Circuit in finding adequate investor control, see *Holden v. Hagopian*, 978 F.2d 1115 (9th Cir. 1992)), and it becomes clear that there is no basis to the SEC's claim that the GPs are under Defendants' control. The GPs should therefore not be under the *Receiver's* control.

C. Defendants' Motion Is Properly Before This Court, Which Has Discretion to Modify the Preliminary Injunction Order At Any Time

Unable to attack the merits of Defendants' arguments, the SEC and Receiver make a series of secondary arguments that also miss their mark. First, the SEC claims that Defendants' Motion is simply an untimely request for reconsideration. But because of the equitable nature of the receivership and courts' broad discretion over injunctive relief generally, the Court can modify its earlier order at any time to fit the needs of the situation; indeed, a court has the power to modify its own injunction *sua sponte*, quite apart from any request by the parties. *See Safe Flight*

1 *Instrument Corp. v. United Control Corp.*, 576 F.2d 1340, 143 (9th Cir. 1978)
2 ("The power of a court of equity to vacate or otherwise modify the prospective
3 effect of its decrees is too well-established to merit extended discussion.")
4 (citations omitted); *Dubose v. Harris*, 434 F.Supp. 227, 232 n.2 (D. Conn. 1977)
5 (citing *McDowell v. Celebrezze*, 310 F.2d 43 (5th Cir. 1962)).

6 The SEC's notion that a preliminary injunction order appointing a receiver
7 cannot be modified once the 28-day deadline for motion to reconsider has passed
8 would be unworkable, because the Court must monitor a receivership "to ensure it
9 is still serving the function for which it was created," which necessarily can take
10 months and sometimes years. *S.E.C. v. Madison Real Estate Group, LLC*, 647 F.
11 Supp. 2d 1271, 1275 (D. Utah 2009). To the extent there was an original purpose
12 served by having the receiver take inventory, secure assets, and "clarify Western's
13 financial affairs," after ten months of forensic sleuthing, a finding that the GPs'
14 books and records are "accurate and reliable," and an admission by the Receiver
15 that he "sees no reason why a group of GPs that collectively own a property …
16 should not be able to retain the property and take sole responsibility for all
17 mortgages and expenses associated with the property," such a purpose no longer
18 exists.

19 By amending its original order and removing the GPs from the receivership,
20 the Court would conform to the obligations of a court of equity to tailor an
21 injunction to the requirements of the situation. The current situation warranting
22 removal of the GPs from the receivership is the transition every receiver must go
23 through from the initial stage of taking inventory to that of ongoing oversight of
24 day-to-day operations. In the present case, those day-to-day operations are so
25 basic – paying taxes, insurance, and filing K-1's – that there simply is no need for
26 the costly presence of a receiver. All that is needed is a partnership secretary –
27 nothing more.

28 Second, the SEC suggests that Defendants have "consented" to a

receivership that encompassed the GPs. Defendants have no such authority to bind the GPs to anything. In addition, Defendants have consistently opposed the imposition of *any* receivership from the beginning of this case.[5] It is disingenuous for the SEC to suggest that Defendants somehow "consented" to a receivership by participating in a Court-mandated meet and confer exercise to draft a proposed preliminary injunction order. (SEC Opp. at 1-2.) At that point, Defendants had no alternative, since it was clear the Court intended to continue the receivership over the GPs despite Defendants' objections. Moreover, Defendants have been guided throughout this litigation by the Court's finding "that there may be no need for a receiver to marshal and preserve assets from misappropriation and dissipation," and its ultimate conclusion that the role of the receivership was simply to "clarify" financial affairs. (Dkt. No. 59, p. 9 of 12.) In practice, the receivership has looked nothing like that. The Receiver has not clarified any financial affairs for any of the entities; he has only muddled and misunderstood them. Even more egregiously, he has exceeded the Court's orders and Defendants' understanding of those orders, and has taken on powers never envisioned by any other parties, essentially proposing an emergency liquidation of investors' assets. Defendants certainly never stipulated to that, and the SEC knows it.

Ultimately, the Court's broad equitable powers, together with its obligation to monitor the receivership to ensure it is still serving the function for which it was created, compels a decision at this time to remove the GPs from the receivership so that they can handle their *very basic ongoing operations* on their own. There is no reason to continue to include the GPs in the receivership going forward and the Court has ample authority to remove them.

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[5] *See* Dkt. No. 14 (motion to dissolve TRO), Dkt. No. 21 (opposition to conversion of TRO into preliminary injunction), Dkt. No. 43 (motion to dismiss for failure to state a claim), Dkt. No. 51 (response to Receiver's second report), Dkt. No. 74 (response to Receiver's First Fee Application), Dkt. No. 167 (surreply to Receiver's First Fee Application), Dkt. No. 183 (response to Receiver's Second Fee Application), Dkt. No. 205 (opposition to Receiver's Motion

D. A Receivership Over The GPs Serves No Purpose

In attempting to provide a rationale for the receivership over the GPs, the SEC and Receiver incorrectly conflate the Receiver's functions as Receiver *over Western* versus his functions as Receiver *over the GPs*, even though the respective obligations of the different entities can result in conflict between the Receiver's duties to both.

With regard to the GPs, the Receiver need only do the following: (1) pay property taxes twice a year, (2) pay insurance once a year, (3) engage an accountant once a year to prepare the Form K-1's, (4) to the extent a GP still has a note owed to Western, make the monthly scheduled payments, and (5) collect amounts owed to the GPs from individual investors. *There are no other functions*.

All of these functions have been carried out successfully for more than 30 years by a partnership administrator. There is no reason why the partnership administrators that have been performing these functions all this time and which the Receiver himself hired to perform these exact duties during the receivership cannot continue to carry out these basic tasks going forward.

In an attempt to make it more complicated than it is, the SEC and Receiver point to a number of functions the Receiver has as Receiver ***over Western*** as justification for the receivership ***over the GPs***. For example, the Receiver keeps saying he has to be receiver over the GPs in order to pay the underlying notes owed by Western to the original sellers of the property (this is the original seller financing Western undertook when it originally acquired the property)(the "Underlying Notes"). The Receiver refers to these payments as the mortgage payments, that he claims if not paid, could trigger default and foreclosure. These are obligations of Western. To the extent the Receiver believes he needs to be in place to make sure these payments are made by Western, that is a function he will

for Leave to Sue LinMar Borrowers).

continue to have as Receiver for Western. The fact he is using that as a purported justification for needing to also be Receiver over the GPs is either disingenuous or demonstrates he still, after all this time, does not understand which entity owes which amount.

Furthermore, as of the date of this filing, the Receiver has, in fact, ceased making the very payments he claims as the reason for his existence. The Receiver has failed to make the following payments that are due on the Underlying Notes owed by Western:

1. $21,570.84 due June 15, 2013 to The Borda Family Trust, for the Dayton II property. This payment is actually the very last payment due on this note: the 120th installment on a 120 installment note. All 119 previous payments were made by Western in a timely manner. The Receiver has failed to make the final payment that would completely retire this Underlying Note in full.
2. $11,843.06 due June 25, 2013 to Northern Nevada Title Co., loan no. 1080366, for the Dayton 4 property (Sec. 21, Lyon County, Nevada);
3. $3,843.25 due June 25, 2013 to Northern Nevada Title Co., loan no. 1080367, for the Dayton 4 property;
4. $12,539.72 due June 25, 2013 to Northern Nevada Title Co., loan no. 1080365, for the Dayton 4 property;
5. $2,972.38 due June 25, 2013 to Schafer Pacific Prop. for Dayton 4;
6. $8,167.07 due July 3, 2013 to the Nell J. Redfield Foundation, loan no. NT0013609;
7. $6,504.67 due July 15, 2013 to American Equities Mortgage, for loan nos. 5122 ($902.34), 5123 ($685.16), 665124 ($1,093.66), and 2005327 ($3,823.51);
8. $3,676.23 due July 3, 2013 to Schafer Pacific Prop. for Silver Springs;
9. $8,331.00 due July 3, 2013 to BCB Ventures, for Silver Springs prop.;
10. $11,772.54 due July 3, 2013 to the Julius & Rose Bunkowski Trust, for the Silver Springs properties;

The brazenness (or complete disorganization) that is required to provide the Court with a reason for one's continued role as Receiver even as you are NOT

doing that specific task, is incredible.

Read through the Receiver's opposition and you will see numerous examples of the Receiver pointing to responsibilities he has as Receiver *over Western* as his purported justification for needing to be receiver *over the GPs* as well.

The Receiver claims that Schooler "drain[ed] [Western] of cash," refused "to put cash back into [Western]," and failed to repay loans "made to entities he controls", i.e., the LinMar Borrowers (see Dkt. No. 192-1). Even if these statements were true (which they are not), they are not relevant to the inquiry at hand and provide no justification for continuing to subject the GPs to the receivership. Asked why he should remain as receiver over the GPs, the Receiver switches the topic to why he believes he should remain as Receiver over Western.

In the first instance, the Receiver mischaracterizes the financial condition of Western. He has yet to include in any of his numerous reports to the Court, the plain fact that Western's receivables exceed its payables by more than $1.5 million and also owns real assets. Simply collecting amounts due and paying amounts owed, will cause $1.5 million of cash to accumulate in Western's bank account. The Receiver's claims to the contrary are misguided.

However, more important to the question before the Court, even if you assume the Receiver's concerns over the cash flow and financial condition of Western and its loans to LinMar are accurate, they have no bearing on whether the GPs should continue to be subjected to the receivership as well.

Removing the GPs from the receivership will have no impact on the Receiver's ability to continue to clarify *Western's financial affairs* and for the Receiver to collect payments from the LinMar entities and make sure Western pays the underlying note obligations. The GPs can be removed from the receivership and have all of their basic operational needs met by the partnership administrators without any negative impact on the Receiver's ability to carry out his

responsibilities as Receiver over Western. The list of supposed horribles the Receiver points to as justification for the GPs being subjected to receivership are obligations belonging to Western, not to the GPs.

The list of GP operational needs is a short and simple one, successfully carried out by the partnership administrators for more than three decades. Once one understands this, it is clear that there is no need to subject the GPs to a costly receiver and his counsel when a partnership administrator is all that is needed. We believe it is this reality that compelled the Receiver to actually concede in his Appraisal Report that he "sees no reason why a group of GPs that collectively own a property … should not be able to retain the property and take sole responsibility for all mortgages and expenses associated with the property."

E. The Receiver Is, In Fact, *Harming* the Investors, Not Protecting Them

The decision to be made regarding the continued inclusion of the GPs in the receivership is not a neutral one. It is not merely a concern regarding the ongoing cost of the receiver or some inconvenience caused by his oversight. The Receiver is, in fact, *harming the investors*, squandering their available cash on purposes not in their interests – spending their money without any input from the investors who originally entered into this type of investment, in large part, due to their ability to have a direct say in all GP decisions.

Much of this harm has been caused by the Receiver's conflict of interest between his role as Receiver *over Western* and his role as Receiver *over the GPs*. For example, as Receiver of Western, he has made demands on the GPs to repay unsecured, non-recourse debt owed to Western. As Receiver of the GPs, his duty of care should have caused him to reject this demand. Instead, he has used precious GP operating capital to repay these unsecured loans, prioritizing non-recourse debt ahead of the GPs' need to preserve cash to cover current and future property tax payments, recklessly putting several GPs' property titles at risk.

Several other questionable decisions have resulted in the GPs using cash for purposes (1) never envisioned by the investors when they entered into the investment, (2) not approved by the investors as required by their charter, and (3) in breach of the Receiver's duty of care owed to the GPs.

There are multiple actions being taken by the Receiver that are causing harm to the investors:

1. The Receiver (in his separate role as Receiver for Western) has failed to make numerous payments on the Underlying Notes owed by Western to the original sellers of the parcels owned by the GPs. (See list on page 14, above). The Receiver has failed to make these payments on the Underlying Notes despite the fact that he has had the GPs continue to make their corresponding payments to Western regarding those same obligations. This causes an accumulation of cash in Western's account – the same account from which the Receiver has paid himself his fees. He is collecting on the debt owed to Western from the GPs, but not making the corresponding payment on the Underlying Notes. From the GP perspective, the GPs are parting with the cash in their accounts, while not receiving the corresponding benefit they are supposed to receive from Western in return: the payment of the underlying obligation. These actions have a double negative impact: depriving the GPs of cash even as their title is placed in jeopardy if corrective action is not taken.
2. The Receiver has used GP operating capital designated for paying taxes, insurance, and other regular operating expenses to repay unsecured, non-recourse, lowest-priority loans owed to Western. The purpose of these payments was to generate cash in Western's account from which the Receiver then paid himself his fees. It is a breach of the Receiver's duty of care owed to the GPs to use limited GP resources to prioritize such low priority debt ahead of property tax payments.

3. The Receiver has used GP operating capital designated for paying taxes, insurance, and other regular operating expenses to repurchase GP units from Western. The purpose of these payments was to generate cash in Western's account from which the Receiver then paid himself his fees. It is a breach of the Receiver's duty of care owed to the GPs to use limited GP resources in this manner.
4. The Receiver has made the above transactions despite the fact it has left some GPs with insufficient balances to be able to pay their next property tax installment, requiring investors to reach into their own bank accounts to replenish funds they would not have to replenish but for the unauthorized actions of the Receiver.
5. Several GPs need to replenish their operating funds. This is done through operational billings by which investors are billed for their pro rata portion of the amount needed by the GP. The Receiver is refusing to undertake any operational billing, which will leave these GPs without adequate resources to make their next due payment obligations, including property tax payments.

Item 1: Not Paying the Underlying Notes

The Receiver has fully paid himself under the first two fee applications, so there are no more payments he can make to himself until the Court rules on his pending third fee application, set for hearing on August 16. It appears through his most recent decisions to have the GPs pay their obligations to Western and then refuse to use that available cash to pay Western's obligations that he is selectively choosing amongst his many obligations to the receivership entities to create an accumulation of cash in Western's account so that he can immediately pay himself if the third fee application is approved. The Receiver must not be allowed to pick and choose his obligations in this manner.

There is sufficient cash in Western's account for Western to be current on all

of the Underlying Notes – there is no reason for these payments to not be made immediately. As set forth in the list on page 14, above, the past due Underlying Note payments total $91,220.76. Western currently has $115,676 in its bank accounts and there are additional receivables coming into Western before the end of the month. The funds are available.

As Receiver *of Western*, the Receiver is required to use the moneys in Western's account to pay the Underlying Notes, an existing obligation on the books of Western (evidenced by the Receiver having made all such payments for the first nine months of the receivership). As Receiver *of the GPs,* the Receiver has a duty to inform the investors that the payments he is making from the GPs to Western are NOT purchasing what the investors believe those payments to be purchasing – namely the corresponding payment of the Underlying Note. The Receiver has not informed the investors that the GP note payments he is making to Western are actually for the purpose of making cash available for him to pay himself his fees as opposed to the designated purpose of preserving title in the GPs' respective properties.

If the GPs were NOT under the control of the Receiver, they could simply redirect their GP note payments directly to the original sellers, bypassing Western completely. This is a protection provided to the GPs under the all-inclusive deed of trust (AITD) entered into with Western when the GPs purchased their interest from Western. (Dkt. No. 14-2 (example of GP AITD).) Should Western ever fail to make a payment on an Underlying Note (an event that has never happened in the 35-year history of Western until the Receiver recently decided to do so), the GPs can simply redirect the payment the GPs owe to Western, paying their obligation directly to the original seller instead. This is a common mechanism in AITDs and serves as a fail-safe protection to the GPs, allowing them to simply and easily preserve their title should Western ever fail to meet its obligation.

The current problem for the GPs is that the very person creating the problem

is also the person who has a hammer grip on the GPs' activities. The Receiver is creating the default by Western (through no fault of Western) and then instead of using the fail-safe provision, the Receiver is inexplicably causing the GPs to nonetheless make their payment to Western – an entity the Receiver knows, through his own actions, is not taking the next step necessary in the AITD process.

Were the GPs not subject to the Receiver, the GPs could simply write their monthly check out to the original sellers of the property instead of writing out their monthly check to Western, even if the Receiver still insisted on not paying the Underlying Notes on behalf of Western. The presence of the Receiver over the GPs combined with his actions as Receiver over Western is creating a perverse deprivation of both control and funds by the GPs.

This is an outlandish enough breach of the Receiver's duty of care owed to the GPs to justify his immediate removal. However, this is not the only problematic transaction.

Item 2: Using GP Assets to Pay Lowest Priority Unsecured Debt

The Receiver recently wrote checks out of GP operating accounts payable to Western for the repayment of unsecured, non-recourse debt. Defendants understand that as Receiver *over Western*, the Receiver has the authority to demand repayment of amounts loaned to other parties. However, as Receiver *over the GPs*, the Receiver's duty of care owed to the GPs requires him to refuse to make any such payment to Western. The debt in question is unsecured, non-recourse debt. There is no consequence to the GPs to not make payment on these loans – they are the lowest priority obligation on the GPs' books. Regardless, the Receiver made these payments out of GP accounts even though some of these payments directly caused some of the GPs to end up with account balances insufficient to make their next property tax payment. For example:

1. $11,731 was paid from BLA Partners to Western, leaving only $899.76 in the BLA Partners bank account.

2. $7,799 was paid from Borderland Partners to Western, leaving only $183.67 in the Borderland Partners bank account.
3. $6,399 was paid from Honey Springs Partners to Western, leaving only $86.41 in the Honey Springs Partners bank account.
4. $4,516 was paid from Horizon Partners to Western, leaving only $183.04 in the BLA Partners bank account.
5. $7,478 was paid from Production Partners to Western, leaving only $127.70 in the Production Partners bank account.
6. $7,690 was paid from Rainbow Partners to Western, leaving only $155.55 in the Rainbow Partners bank account.
7. $4,320 was paid from Suntec Partners to Western, leaving only $150.59 in the Suntec Partners bank account.
8. $7,210 was paid from Victory Lap Partners to Western, leaving only $127.65 in the Victory Lap Partners bank account.
9. $4,320 was paid from Valley Vista Partners to Western, leaving only $416.95 in the Valley Vista Partners bank account.

It is clear that the Receiver prioritized unsecured debt obligations of the GPs ahead of the GPs' ability to make their property tax payments simply to make cash available in Western's account so the Receiver could pay himself his fees. The investors were never notified of these transactions, let alone given an opportunity to decide whether they wanted their limited operating funds used in this needless manner.

Item 3: Using GP Assets to Purchase Western's GP Units

$51,000 of GP operating funds that investors contributed to their respective GPs for the express purpose of paying taxes and insurance has instead been used by the Receiver to purchase GP units from Western at face value ($1.00 per unit). Not a single investor was asked if this was how they wanted *their* funds used. In direct violation of the GPs' respective charters, funds belonging to the GPs were used in a manner never authorized by the GPs.

Item 4: Causing Lack of Sufficient Funds in Certain GPs

As listed above under Item 2, the actions of the Receiver in making payments that were not only not necessary, but actually contrary to the interests of

the GPs, left the GPs listed above with bank balances below $1,000 for no reason other than the inexplicable actions of the Receiver in using limited resources to prioritize repayment of unsecured debt. These GPs now do not have enough money in their accounts to pay their next tax payment, which will trigger unnecessary late fees and endanger their title.

Item 5: Refusing to Conduct Operational Billing That Is Necessary In Order for Certain GPs to Make Upcoming Property Tax Payments

There are 28 GPs that currently have bank balances of less than $5000, meaning each of them needs to engage in operational billing. Operational billing is the process that has been used by the partnership secretaries for the past three decades to bill individual investors for their pro rata portion of GP expenses. When bank balances drop to a point where the GP does not have sufficient funds for its next payment obligation, e.g., the next property tax installment, the partnership secretaries have issued operational billings to individual investors. The investors then return their pro rata portion and the GPs' funds are replenished to allow continued payment of the GPs' basic tax and insurance obligations.

The Receiver admits that he has refused to engage in operational billing, meaning these GPs are at risk for missing their next property tax payment. (Dkt. No. 203, p. 15 of 17, l. 9.) Some of the counties in which the subject properties reside charge substantial late fees and penalties – sometimes causing a doubling of the tax obligation within a short period of time.

The Receiver has pointed to the stay provision of the Preliminary Injunction Order as providing protection to the GPs from foreclosure actions, but the stay provision does not stop the assessment and accrual of late fees and penalties. Defendants are not aware of an offer from the Receiver to post a bond in the amount of the potential late fees and penalties the 28 GPs with insufficient bank balances may be facing as early as this fall, meaning it is the GPs who would be saddled with these additional and wholly unnecessary additional costs for no

reason other than the Receiver's refusal to allow the partnership secretaries to conduct the same routine operational billing that has been conducted by the GPs for the past 30 years without incident. Nor have the investors been informed of their situation and/or given an opportunity to decide which course of action they would like to take.

Thus, it is clear that while the SEC and the Receiver purport to be protecting investor interests, and the Receiver claims to be saving the investors from foreclosure, it is actually the *Receiver's* own actions that are posing the most serious and immediate harm to the GPs, including putting them at risk of foreclosure for the first time in the history of Western's existence.

The GPs need to be removed from the receivership immediately before irreparable harm is caused to the investors.

III.
CONCLUSION

For the reasons stated above and in Defendants' Motion for Modification of the Preliminary Injunction Order to Remove the Real Estate General Partnerships from the Receivership, Defendants respectfully request that the Court modify the prior Preliminary Injunction Orders and remove the GPs from the receivership.

DATE: July 19, 2013

Respectfully submitted,

___/s/Eric J. Hougen__________

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CERTIFICATION

I hereby certify that on the 19th day of July 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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