

ROBB EVANS
Receiver of
D.W. Heath & Associates, Inc.;
PCM Fixed Income Fund I, LLC;
Private Capital Management, Inc.;
Private Collateral Management, Inc.
and the Schlarmann Interests

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Securities and Exchange Commission v. D. W. Heath & Associates Inc., et al.
CASE No. CV-04-02949 JFW (Ex)

**Notice of Motion and Motion to Approve Settlement Agreement and
Release with Thomas A. Johnson and the Alderwood Group, LLC;
Memorandum of Points and Authorities and Declaration of Kenton
Johnson in Support Thereof**

Filed May 20, 2005

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7 ROBB EVANS

8
9 **UNITED STATES DISTRICT COURT**
10 **CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION**

11
12 SECURITIES AND EXCHANGE
COMMISSION,

13 Plaintiff,

14 v.

15 D.W. HEATH & ASSOCIATES, INC.,
16 etc., et al.,

17 Defendants.

CASE NO. CV 04-02949 JFW (Ex)

**NOTICE OF MOTION AND
MOTION TO APPROVE
SETTLEMENT AGREEMENT AND
RELEASE WITH THOMAS A.
JOHNSON AND THE
ALDERWOOD GROUP, LLC;
MEMORANDUM OF POINTS AND
AUTHORITIES AND
DECLARATION OF KENTON
JOHNSON IN SUPPORT THEREOF**

DATE: June 13, 2005

TIME: 1:30 p.m.

PLACE: Courtroom 16
312 N. Spring Street
Los Angeles, CA

FRANZEL ROBINS BLOOM & CSATO, L.C.
6500 WILSHIRE BOULEVARD, 17TH FLOOR
LOS ANGELES, CALIFORNIA 90048-4920
(323) 852-1000

1 PLEASE TAKE NOTICE that on June 13, 2005 at 1:30 p.m. or as soon
2 thereafter as counsel may be heard in Courtroom 16 of the above-entitled court
3 located at 312 N. Spring Street, Los Angeles, California, Robb Evans as permanent
4 receiver ("Receiver") of D.W. Heath & Associates, Inc., Private
5 Capital Management, Inc., Private Collateral Management, Inc. and PCM Fixed
6 Income Fund I, LLC and their subsidiaries and affiliates (collectively the
7 "Receivership Defendants") will and does hereby move this Court for an order
8 approving the Receiver's proposed Settlement Agreement and Release by and
9 among the Receiver, on one hand, and Thomas A. Johnson ("Johnson") and The
10 Alderwood Group, LLC ("Alderwood"), on the other (the "Settlement Agreement"),
11 a true and correct copy of which is attached to the declaration of Kenton Johnson as
12 Exhibit 2. The Settlement Agreement provides for payment to Johnson in the sum
13 of \$310,000.00, and for the Receiver, on one hand, and Johnson and Alderwood, on
14 the other, to mutually release all claims, rights, demand, actions and causes of action
15 that each may have against the other arising out of or pertaining to the Schlarmann
16 Interests, the Receivership Defendants, and the receivership estate, including but not
17 limited to the Northwoods Resort and Conference Center ("Northwoods").

18 This motion is made pursuant to Local Rules 66-7 and 66-8 and the
19 authorities cited hereinafter, and is based on this Notice of Motion and Motion, the
20 memorandum of points and authorities and declaration of Kenton Johnson in
21 support hereof, and on such pleadings, records and files of the Court as the Receiver
22 may request the Court take judicial notice of in connection with the hearing on the
23 motion, and on such further oral and documentary evidence and arguments of
24 counsel as may be presented at the hearing on the motion.

25 PLEASE TAKE FURTHER NOTICE that notice of this Motion is provided
26 pursuant to the Court's Order: (1) Approving Receiver's Report for the Period
27 July 12, 2004 through December 31, 2004; (2) Approving Receiver's Proposed
28 Claims Filing and Allowance Procedures; and (3) Granting an Order Limiting

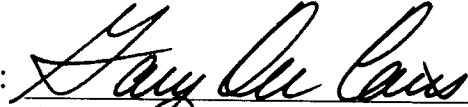
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Notice Under Local Rule 66-7 in Connection with Administrative and Similar
Motions Under Local Rule 66-7 ("Order Limiting Notice") filed on March 4, 2005,
pursuant to which a copy of this Motion has been posted to the Receiver's website
for this case at www.heath-receiver.com where it may be viewed in its entirety.

DATED: May 19, 2005

FRANDZEL ROBINS BLOOM & CSATO, L.C.
GARY OWEN CARIS
LESLEY ANNE HAWES

By: 
GARY OWEN CARIS
Attorneys for Permanent Receiver,
ROBB EVANS

1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 **I.**

3 **INTRODUCTION**

4 By this Motion, the Receiver seeks an order approving a proposed Settlement
5 Agreement and Release with Thomas A. Johnson and The Alderwood Group, LLC
6 ("Alderwood"), in which he is the principal and sole owner. Johnson, through
7 Alderwood, has been the on-site manager of the Northwoods Resort Hotel and
8 Conference Center ("Northwoods") in Big Bear Lake, California since August 1999
9 under a written management agreement that by its terms is not scheduled to
10 terminate until December 31, 2010. The records of the receivership entities also
11 indicate Johnson also holds a 12.5% ownership interest in Northwoods.

12 On February 28, 2005, the Court conducted a hearing on the Receiver's
13 motion to sell the Northwoods property, and approved the conduct of an auction
14 with an opening bid required to generate net proceeds to the receivership estate of
15 \$9,065,000, to take into account possible sales commissions. The auction sale
16 produced multiple qualified bidders, and the successful high bid was in the amount
17 of \$10,265,000, without sales commissions, over \$1.2 million more than the
18 minimum.¹ The Receiver has consummated and closed the sale of Northwoods to a
19 third party purchaser pursuant to the Court's Order (1) Approving Marketing and
20 Sale Procedures for Sale of Real Property Commonly known as Northwoods Resort
21 Hotel and Conference Center; and (2) Authorizing and Confirming Sale of
22 Northwood's Property Subject to Approved Bidding Procedures filed March 1,
23 2005. The net proceeds from the sale of Northwoods are in excess of
24 \$10,159,121.00. As set forth hereafter, Thomas Johnson provided the Receiver
25

26
27 ¹ Pursuant to Court order, a fee of less than \$100,000 was paid to The
28 Redfield Group, Inc. to assist the Receiver in promoting and advertising the auction.

1 substantial assistance in the management of Northwoods post-receivership and in
2 providing records and other information to the potential interested purchasers that
3 ultimately made the auction of the property so successful and beneficial to the
4 receivership estate.

5 The Receiver has negotiated an agreement with Thomas Johnson and
6 Alderwood resolving their respective rights, claims and interests in and to
7 Northwoods and against the receivership estate pursuant to the Settlement
8 Agreement and Release ("Settlement") attached as Exhibit 2 to the declaration of
9 Kenton Johnson in support of this Motion. Pursuant to the Settlement, Thomas
10 Johnson and Alderwood will accept the sum of \$310,000.00 in full satisfaction of all
11 rights, claims and interests each may have in Northwoods and its proceeds and in
12 full satisfaction and resolution of all claims, demands, rights and actions he may
13 have against the receivership estate and the various receivership entities, including
14 the Schlarmann Interests and the Receivership Defendants in this case. The
15 Receiver submits this Settlement is fair and beneficial to the receivership estate
16 under the circumstances and should be approved.

17 II.

18 STATEMENT OF FACTS

19 On April 28, 2004, the United States Securities and Exchange Commission
20 ("SEC") filed this civil enforcement action against Daniel Heath ("Heath"), Denis
21 Timothy O'Brien ("O'Brien") and the entities D.W. Heath & Associates, Inc.
22 ("Heath & Associates"), Private Capital Management, Inc. ("PCM"), Private
23 Collateral Management, Inc. ("Collateral"), and PCM Fixed Income Fund I, LLC
24 ("Fund"). Shortly after this action was instituted, the SEC also sought and obtained
25 a temporary restraining order as to all defendants and appointment of Robb Evans as
26 a temporary receiver over Heath & Associates, PCM, Collateral, Fund and their
27 subsidiaries and affiliates. The SEC and Heath subsequently entered into a
28 Stipulation and Order Appointing a Permanent Receiver filed May 18, 2004 in the

1 SEC Action by which the Receiver has been appointed Permanent Receiver over the
2 Federal Receivership Entities.

3 On July 2, 2004, the Riverside County District Attorney initiated a criminal
4 action against Heath, O'Brien, Heath's father, John William Heath, and Larre Jaye
5 Schlarmann ("Schlarmann"), in the action entitled People of the State of California
6 v. Daniel William Heath, et al., Case No. RIF 117775 pending in the Superior Court
7 of California, County of Riverside ("Criminal Action"). On July 21, 2004, the
8 Riverside Superior Court issued its Order Appointing Robb Evans as Receiver of the
9 Schlarmann Interests Pursuant to Penal Code section 186.11 ("July 21 Receivership
10 Order"). The July 21, 2004 Receivership Order was subsequently amended by order
11 entered November 19, 2004 in the Criminal Action to expand the scope of assets
12 subject to the receivership to include certain real property containing avocado
13 groves located in Bonsall, California ("Amended Schlarmann Order"). The July 21,
14 2004 Receivership Order and the Amended Schlarmann Order are referred to
15 collectively herein as the "Schlarmann Receivership Order." Pursuant to the
16 Schlarmann Receivership Order, the Receiver has been appointed Receiver over all
17 of the Quizno's Entities and the Hotel Entities, as those terms are defined in the
18 Schlarmann Receivership Order, and the Bonsall property.

19 The Receiver subsequently sought and obtained orders from the state court in
20 the Criminal Action and an order of this Court providing that the responsibility for
21 the administration and supervision of the receivership estate of the Schlarmann
22 Interests be transferred to this Court. The Court's order regarding the administration
23 of the Schlarmann Interests by this Court was entered on March 3, 2005.

24 Among the assets of the receivership estates is the Northwoods property. As
25 set forth in the Receiver's prior motion to approve the sale of Northwoods, which
26 was heard on February 28, 2005, Northwoods is a 148-room hotel with a complete
27 conference center. The ownership structure of the Northwoods property is as
28 follows: the general partner of Northwoods is Hotel Management, Inc. Hotel

1 Management, Inc. is a 1.5% owner of Northwoods and operates the resort. The
2 limited partners are NADM Equities, L.P., with a 38% interest, TITL Equities, L.P.,
3 with a 38% interest, Thomas A. Johnson, with a 12.5% interest, and the Barney
4 Family Trust with a 10% interest. The shareholders of the general partner are Larre
5 Schlarmann ("Schlarmann") with a 45% interest, Daniel Heath ("Heath") with a
6 45% interest, and Sharre Schlarmann, with a 10% interest. As previously reported,
7 NADM Equities, L.P. was owned and controlled by Schlarmann and TITL Equities,
8 L.P. was owned and controlled by Heath. The Barney Family Trust subsequently
9 abandoned its 10% limited partnership interest.

10 Since August 1999, Thomas Johnson has been the on-site manager of
11 Northwoods, pursuant to a written Management Agreement dated August 1, 1999
12 between Alderwood as manager and Northwood Resort Holdings, L.P. as owner
13 ("Management Agreement"). Under the Management Agreement, Alderwood was
14 to manage Northwoods by and through Johnson as the on-site general manager. In
15 2001, the Management Agreement was amended to extend its term, and pursuant to
16 the amendment, the Management Agreement was not scheduled to expire until
17 December 31, 2010. Johnson's compensation under the Management Agreement
18 includes a base payment of \$265,000 per year as well as incentive payments
19 calculated based on actual performance and revenues of Northwoods. For the one
20 year period preceding this settlement based on records as of May 2005, the
21 aggregate annual management fee payments due under the Management Agreement
22 are approximately \$310,000.00.

23 In addition to Johnson's 12.5% ownership interest in Northwoods, Thomas
24 Johnson and Alderwood had potential claims against the receivership estate based
25 on the Management Agreement and its termination by the Receiver after the closing
26 of the sale of Northwoods, approximately five and one-half years prior to its
27 contractual termination date. All of these rights and claims will be resolved
28 through the proposed Settlement.

1 The Settlement provides for a cash payment to Johnson in the sum of
2 \$310,000.00 upon court approval of the Settlement.² The Settlement provides for
3 mutual releases between the Receiver and receivership estate, on one hand,
4 including all the receivership entities, the Schlarmann Interests and the Receivership
5 Defendants in this action, and Thomas Johnson and Alderwood on the other.

6 The Receiver submits that the proposed Settlement is fair and beneficial to the
7 estate. In exchange for the settlement payment, Johnson and Alderwood are
8 relinquishing (a) potential claims based on Johnson's record ownership interest in
9 Northwoods, (b) potential claims based on early termination of the Management
10 Agreement, and (c) potential claims based on the services rendered by Johnson in
11 connection with the promotion of the auction and the successful sale of the
12 Northwoods property for over \$1.2 million more than the minimum bid approved by
13 the Court. The payment represents a small fraction of the net proceeds of the
14 Northwoods sale and of the potential value of the stated ownership percentage of
15 Johnson on the books of the limited partnership. The payment represents less than
16 one-quarter of the \$1.2 million in excess auction proceeds from the Northwoods
17 sale, which were in no small part generated by the professionalism, cooperation and
18 continued effective management of Northwoods by Johnson after the receivership
19 and during the marketing and pre-auction sale period. The Settlement resolves
20 competing claims and avoids litigation to resolve the rights and demands of the
21 parties against one another. The dollar amount of the Settlement payment is far less
22 than the amount Thomas Johnson could have claimed as an ownership share in the
23

24 ² The settlement payment amount was a negotiated figure agreed to by the
25 parties in consideration of the claims of Johnson and Alderwood against
26 Northwoods and the receivership estate and the Receiver's defenses to those claims.
27 In evaluating the reasonableness of the settlement payment, the Receiver considered
28 that the payment amount is equivalent to approximately one year of base and
incentive management fees under the Management Agreement.

1 Northwoods proceeds and reflects the parties' compromise of claims based on the
2 parties' mutual claims and demands. The Receiver therefore requests approval of
3 the Settlement as a fair and equitable compromise of controversies under the
4 circumstances.

5
6 **III.**
7 **THE SETTLEMENT IS FAIR AND REASONABLE**
8 **AND SHOULD BE APPROVED**

9 Pursuant to Local Rule 66-8, a receiver is directed to administer receivership
10 estates "as nearly as possible in accordance with the practice in the administration of
11 estates in bankruptcy." Under Rule 9019 of the Federal Rules of Bankruptcy
12 Procedure, the court in a bankruptcy case may approve a proposed compromise of
13 controversies after notice and an opportunity for hearing. Ninth Circuit decisions in
14 In re A & C Properties, 784 F. 2d 1377 (9th Cir. 1986) and In re Woodson, 839 F.
15 2d 610 (9th Cir. 1988) establish four factors the court must consider in ruling on the
16 approval of compromises in bankruptcy:

- 17 (a) The probability of success in the litigation; (b) the
18 difficulties, if any, to be encountered in the matter of
19 collection; (c) the complexity of the litigation involved,
20 and the expense, inconvenience and delay necessarily
21 attending it; (d) the paramount interest of the creditors and
22 a proper deference to their reasonable views in the
23 premises.

24 In re A & C Properties, 784 F. 2d at 1381. See also In re Woodson, 839 F. 2d at
25 620.

26 This test is satisfied with respect to the Settlement with Thomas Johnson and
27 Alderwood. The Settlement provides for Thomas Johnson to receive a payment of
28 \$310,000.00 in exchange for which (a) he and Alderwood relinquish all claims
under the Management Agreement, (b) he relinquishes all claims to the proceeds of

1 Northwoods based on his record ownership interest, and (c) all other claims or
2 demands between the parties are mutually released. The Settlement resolves these
3 claims and demands without the cost and expense of litigation, and the Settlement is
4 well within the reasonable range of a potential outcome in litigation given that the
5 record ownership interest of Johnson if recovered in full would exceed the amount
6 of the payment under the Settlement. The Settlement is therefore beneficial to
7 creditors and the estate, avoids the expense, risk and delay of litigation and is a fair
8 and reasonable compromise under the circumstances. The Receiver therefore
9 submits the Settlement should be approved.


10 **IV.**

11 **CONCLUSION**

12 Based upon the foregoing, the Receiver respectfully requests that the Court
13 grant this Motion and approve the proposed Settlement.

14
15 DATED: May 19, 2005

FRANDZEL ROBINS BLOOM & CSATO, L.C.
GARY OWEN CARIS
LESLEY ANNE HAWES

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18 By: 
19 GARY OWEN CARIS
20 Attorneys for Permanent Receiver,
21 ROBB EVANS
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1 to include certain real property containing avocado groves located in Bonsall,
2 California ("Amended Schlarmann Order"). The July 21, 2004 Receivership Order
3 and the Amended Schlarmann Order are referred to collectively herein as the
4 "Schlarmann Receivership Order." Pursuant to the Schlarmann Receivership Order,
5 the Receiver has been appointed Receiver over all of the Quizno's Entities and the
6 Hotel Entities, as those terms are defined in the Schlarmann Receivership Order, and
7 the Bonsall property.

8 3. The Receiver subsequently sought and obtained orders from the state
9 court in the Criminal Action and an order of this Court providing that the
10 responsibility for the administration and supervision of the receivership estate of the
11 Schlarmann Interests be transferred to this Court. The Court's order regarding the
12 administration of the Schlarmann Interests by this Court was entered on March 3,
13 2005.

14 4. As set forth in the Receiver's second and third reports on file with the
15 Court, among the assets of the receivership estate is the Northwoods Resort and
16 Conference Center located at 40650 Village Drive, Big Bear Lake, California 92315
17 ("Northwoods"). Northwoods is a 148-room hotel with a complete conference
18 center.

19 5. The ownership structure of the Northwoods property is as follows: the
20 general partner of Northwoods is Hotel Management, Inc. Hotel Management, Inc.
21 is a 1.5% owner of Northwoods and operates the resort. The limited partners are
22 NADM Equities, L.P., with a 38% interest, TITL Equities, L.P., with a 38% interest,
23 Thomas A. Johnson, with a 12.5% interest, and the Barney Family Trust with
24 a 10% interest. The shareholders of the general partner are Larry Schlarmann
25 ("Schlarmann") with a 45% interest, Daniel Heath ("Heath") with a 45% interest,
26 and Sharre Schlarmann, with a 10% interest. As previously reported, NADM
27 Equities, L.P. was owned and controlled by Schlarmann and TITL Equities, L.P.
28 was owned and controlled by Heath. The Barney Family Trust has abandoned its

1 10% limited partnership interest.

2 6. The Receiver's investigation indicates that since August 1999, Thomas
3 Johnson has been the on-site manager of Northwoods, pursuant to a written
4 Management Agreement dated August 1, 1999 between Alderwood as manager and
5 Northwood Resort Holdings, L.P. as owner ("Management Agreement"). Under the
6 Management Agreement, Alderwood was to manage Northwoods by and through
7 Johnson as the on-site general manager. A true and correct copy of the Management
8 Agreement is attached hereto as Exhibit 1.

9 7. Under the Management Agreement, Alderwood was to manage
10 Northwoods by and through Johnson as the on-site general manager. In 2001, the
11 Management Agreement was amended to extend its term, and pursuant to the
12 amendment, the Management Agreement was not scheduled to expire until
13 December 31, 2010. Johnson's compensation under the Management Agreement
14 includes a base payment of \$265,000 per year as well as incentive payments
15 calculated based on actual performance and revenues of Northwoods. For the one
16 year period preceding this settlement based on records as of May 2005, the
17 aggregate annual management fee payments due under the Management Agreement
18 are approximately \$310,000.00.

19 8. The Receiver has consummated and closed the sale of Northwoods to a
20 third party purchaser pursuant to the Court's Order (1) Approving Marketing and
21 Sale Procedures for Sale of Real Property Commonly known as Northwoods Resort
22 Hotel and Conference Center; and (2) Authorizing and Confirming Sale of
23 Northwood's Property Subject to Approved Bidding Procedures filed March 1,
24 2005. Northwoods was sold for a gross purchase price of \$10,265,000.00, which
25 was based on overbids of more than \$1 million above the minimum required
26 proceeds to the estate under the sale order of \$9,065,000.0. The receivership estate
27 has obtained net proceeds of sale of approximately \$10,159,121.00.

28

1 9. Thomas Johnson provided substantial assistance to the Receiver in
2 concluding the sale of Northwoods. Johnson continued to manage Northwoods after
3 the receivership, prepared the Northwoods property and books for inspection by
4 interested bidders, prepared the property and books for transfer to the new owner
5 and ensured a smooth transition in the sale to the new owner with minimal
6 disruption to the Northwoods customers. The continued professional management
7 of Northwoods with minimal disruption as the Receiver took control of the asset and
8 sold this ongoing business helped the Receiver to maximize the value obtained for
9 Northwoods, to the benefit of the receivership estate.

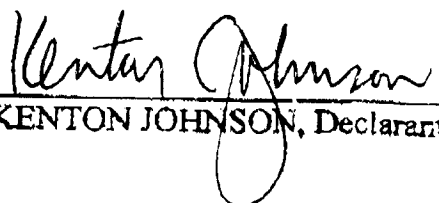
10 10. In addition to Johnson's 12.5% ownership interest in Northwoods,
11 Thomas Johnson and Alderwood had claims against the receivership estate based on
12 the Management Agreement and its termination by the Receiver after the closing of
13 the sale of Northwoods, approximately five and one-half years prior to its
14 contractual termination date.

15 11. The Receiver has negotiated an agreement with Thomas Johnson and
16 Alderwood resolving their respective rights, claims and interests in and to
17 Northwoods and against the receivership estate pursuant to the Settlement
18 Agreement and Release ("Settlement"), true and correct copy of which is attached
19 hereto as Exhibit 2. Pursuant to the Settlement, Thomas Johnson and Alderwood
20 will accept the sum of \$310,000.00 in full satisfaction of all rights, claims and
21 interests each may have in Northwoods and its proceeds and in full satisfaction and
22 resolution of all claims, demands, rights and actions he may have against the
23 receivership estate and the various receivership entities, including the Schlarmann
24 Interests and the Receivership Defendants in this action. The Settlement provides
25 for mutual releases between the Receiver and receivership estate, on one hand,
26 including all the receivership entities, the Schlarmann Interests, and the
27 Receivership Defendants in this action, and Thomas Johnson and Alderwood on the
28 other.

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1 12. The settlement payment amount was a negotiated figure agreed to by
2 the parties in consideration of the claims of Johnson and Alderwood against
3 Northwoods and the receivership estate and the Receiver's defenses to those claims.
4 In evaluating the reasonableness of the settlement payment, the Receiver considered
5 that the payment amount is equivalent to approximately one year of base and
6 incentive management fees under the Management Agreement. The settlement
7 payment represents a small fraction of those proceeds and the stated ownership
8 percentage of Johnson on the books of the limited partnership. The Settlement
9 allows the Receiver to avoid costly litigation over the nature and extent of any
10 ownership rights or claims of Johnson to Northwoods, and any other claims Johnson
11 and Alderwood may have against the receivership estates, including claims under
12 the Management Agreement. The Receiver recommends the Settlement as a fair
13 and reasonable compromise of disputed claims that is beneficial to the receivership
14 estate.

15 I declare under penalty of perjury that the foregoing is true and correct and
16 that this declaration was executed on May 19th, 2005 at Needles,
17 CA.

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21 KENTON JOHNSON, Declarant
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FRANZEL ROBINS BLOOM & CSATO, L.C.
6500 WILSHIRE BOULEVARD, 17TH FLOOR
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SERVICE LIST

Securities and Exchange Commission v. D.W. Heath & Associates, Inc., et al.
U.S.D.C. Case No. CV 04-02949

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|----|---|--|
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