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Securities and Exchange Commission v. High Park Investment Group, Inc., et al.
CASE No. SACV 05-1090 CJC (MLGx)

Receiver's Consolidated Reply to Oppositions and Response to Motion for Reconsideration of Ruling on Motion by Receiver for Instructions and Orders Invalidating Purported Notes and Liens Securing Notes of Investors as Secured Debts and for Other Relief

Dated June 12, 2006

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

HIGH PARK INVESTMENT GROUP, INC., a Nevada corporation, HARBOR FINANCIAL INVESTMENT GROUP, INC., a Nevada corporation, EDWARD R. SHOWALTER,

Defendants.

CASE NO. SACV 05-1090 CJC (MLGX)

RECEIVER'S CONSOLIDATED REPLY TO OPPOSITIONS AND RESPONSE TO MOTION FOR RECONSIDERATION OF RULING ON MOTION BY RECEIVER FOR INSTRUCTIONS AND ORDERS INVALIDATING PURPORTED NOTES AND LIENS SECURING NOTES OF INVESTORS AS SECURED DEBTS AND FOR OTHER RELIEF

DATE: JUNE 19, 2006
TIME: 1:30 P.M.
PLACE: COURTROOM 9B

Robb Evans & Associates LLC as Permanent Receiver ("Receiver") of High Park Investment Group, Inc., Harbor Financial Investment Group, Inc. and their subsidiaries and affiliates ("Receivership Entities") hereby submits this Consolidated Reply to the oppositions and response to the Receiver's Motion for Reconsideration and for other relief filed by Manoucher Adli ("Adli"), William Bame ("Bame"), the Irwin Group,[1] and the Coleman Group[2] and the joinder in the Irwin Group's opposition filed by 1492 LLC ("1492").

I. THE BANKRUPTCY COURT IS NOT "UNIQUELY QUALIFIED" TO DETERMINE THAT THE INVESTOR NOTES AND DEEDS OF TRUST ARE UNENFORCEABLE UNDER CALIFORNIA LAW AS THEY ARE ILLEGAL INVESTMENT CONTRACTS THAT VIOLATE THE FEDERAL SECURITIES LAWS

At the May 15, 2006 hearing on the Receiver's Motion for Instructions, the Court sua sponte raised the question of whether the issues presented by the receivership should instead be resolved in the forum of the bankruptcy court. The oppositions of Bame and Adli to the Receiver's Motion for Reconsideration argue without authority that the Bankruptcy Court is somehow in a better position to address what Adli's counsel concedes should be a question of law determined by the Court as to whether the notes and deeds of trust represent illegal investment contracts that are unenforceable as a matter of law under the California Civil Code and the federal securities laws.

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[1] This term is used for convenience to refer to the group of investors including Ralph Irwin who are represented by Bruce Douthit as counsel. In addition to other arguments addressed in this Consolidated Reply, the Irwin Group's opposition continues to make assertions regarding the physical condition of the properties, most of which was addressed in the Supplemental Declaration of Kenton Johnson previously filed with the Court. Nevertheless, in response, the Receiver attaches hereto as Exhibit 1 its Supplemental Report dated June 5, 2006 as its reply to those issues raised by the Irwin Group.

[2] This term is used for convenience to refer to the group of investors including Earl Coleman who are represented by Thomas Kieviet as counsel.

None of the extensive opposition papers filed by multiple parties to the Receiver's Motion for Instructions raised the argument that the receivership estate should be placed in bankruptcy. In the Receiver's Motion for Reconsideration, the Receiver has cited numerous reported decisions in civil enforcement actions and almost a dozen pending actions known to the Receiver in which receiverships were established and have involved extensive and complex litigation as well as extensive liquidation of claims and assets. In response, none of the opposition papers that claim bankruptcy is "uniquely" suited to the disposition of the issues and assets involved have cited any reported decisions or unreported pending cases which establish that federal equity receiverships imposed in governmental police and regulatory actions are routinely placed in bankruptcy for administration and determination of complex legal issues. The oppositions in no way establish that bankruptcy is the forum that is either routinely or appropriately selected to manage a complex federal equity receivership. Instead, the cases cited by the Receiver indicate in fact it is the District Court that is the chosen forum for such matters to be handled.

The Bankruptcy Code is designed to deal with financially distressed businesses and individuals, providing mechanisms for them to repay their obligations through rehabilitation of their finances or liquidation of their assets. The Bankruptcy Code was not designed as a remedy for shutting down fraudulent businesses and dealing with the legal challenges to the business's fraudulent activities that arise in federal equity receiverships. Rather than moving cases from an equity receivership to bankruptcy court for resolution in such circumstances, cases such as the FTC v. Ameridebt, Inc. case, cited in the Receiver's Motion for Reconsideration, and the First Alliance Mortgage case[3] in this district, illustrate that

[3] In re First Alliance Mortgage Co., 269 B.R. 428, 442 (C.D. Cal. 2001) (one of several reported decisions issued in connection with a bankruptcy case and adversary proceeding, as to which the district court withdrew the reference from the bankruptcy court).

such proceedings are often moved from bankruptcy to the District Court given the nature of the legal issues and disputes that arise and must be determined, not unlike the invalidity of the notes and deeds of trust as illegal investment contracts in this case.

The relief sought by the Receiver is not a "lien avoidance" claim under a preference or fraudulent conveyance theory under a bankruptcy statute. The basis of this relief is California contract law, which requires contracts to be legal and to have as their object a legal transaction in order to be enforceable, and federal securities laws, which deem the investment contracts at issue to be illegal. The principal relief sought by the Receiver in the Receiver's Initial Motion was an order that the notes issued to investors by High Park Investment Group, Inc. ("High Park") secured by deeds of trust on various receivership properties constitute illegal investment contracts granted as part of a fraudulent and unlawful investment scheme in violation of the securities laws and that the notes and therefore the deeds of trust securing them were invalid and unenforceable. The violations of the securities laws represented by these transactions were the basis of plaintiff Securities and Exchange Commission's civil enforcement action in this case, its complaint and its application for a temporary restraining order and preliminary injunction against the defendants. Nothing under the Bankruptcy Code and Federal Rules of Bankruptcy Procedure makes the Bankruptcy Court particularly suited to resolve this legal issue.

Bame argues that under the TLC Investments and Trade Co. decision, liquidation is appropriate through a federal equity receivership only in "rare cases." This statement is dicta as in fact in that case, a complex equity receivership was administered in the District Court involving both liquidation of numerous real and personal property assets and determination of extensive litigation claims.

Neither Bame's Opposition nor Adli's Opposition touting the procedures of bankruptcy address the additional burden, delay and expense that will result for the

estate if the receivership entities are placed in bankruptcy. It is noteworthy that neither creditor has provided declaration evidence to oppose the evidentiary showing made by the Receiver through his counsel with over 25 years of bankruptcy experience that there are significant additional costs and risks to the creditors if the receivership entities are administered in bankruptcy.

II. THE OPPOSITION TO STREAMLINED DISCOVERY AND TRIAL PROCEDURES IS DISINGENUOUS

The Receiver's Initial Motion was noticed to all known creditors of the receivership estate. All known investor creditors were served with all Motion pleadings in addition to a notice of hearing. In addition, all known investor creditors and other creditors of the estate were served with the Receiver's Motion for Reconsideration. Of those 121 investors and numerous other institutional lienholders and employees, only a relative handful of creditors have objected to the relief sought by the Receiver. The failure to oppose the relief sought by the Receiver by these two Motions can clearly be taken as consent to the Receiver's Motions by those who have failed to respond (see Local Civil Rule 7-12), and of course the Receiver does not propose to conduct a trial against those investors who concede the propriety of the requested relief. Only a handful of investors would be part of a trial.

While Bame argues that the Bankruptcy Court is the forum "uniquely" suited to determine the disputed issues in this case, Bame also asserts that the Receiver's proposed discovery and trial procedures improperly deprive his client and others of the right to a jury trial. In fact, the nature of the relief sought as declaratory or equitable relief as to the enforceability of the notes and deeds of trust is not a claim at law to which a right to jury trial would attach. See, e.g., Scheurenbrand v. Wood Gundy Corp., 8 F. 3d 1547, 1551 (claim for rescission arising out of illegal sale of unregistered securities is an equitable proceeding); Lombardo Turquoise Milling and Mining Co., Inc. v. Hemanes, 430 F. Supp. 429, 433 (D. Nev. 1977) (quiet title

claim is equitable claim to which no right to jury trial attaches). Ironically, even if a jury trial were available, the Local Bankruptcy Rules for the Central District of California have a mechanism by which the reference of an adversary proceeding involving a jury trial can be withdrawn to the District Court on motion of any party, placing the determination of the issues involved before the District Court, not the Bankruptcy Court if the matter were subject to trial by jury. See Local Bankruptcy Rule 9015-2(g).

Bame also mischaracterizes the Receiver's Motion for Reconsideration and the scope of discovery and procedures contemplated. The Receiver did not propose to limit the discovery available to interested parties to the information available from the Receiver only, but rather indicated that based on the narrow factual and legal issues most, if not all, of the discovery could be obtained on an expedited basis from the Receiver itself.

Adli conceded on the record that the issues can be determined as a matter of law based on the current state of the record. The Adli Opposition's recitation of a string of Bankruptcy Code and Rules citations does not provide supporting authority either for the inadequacy of the due process afforded by the procedures proposed in the Motion or for the claim that the Bankruptcy Court offers a better forum to resolve what Adli concedes is a dispute under the federal securities laws and their intersection with California contract and real property law. The Court can ensure that the parties' procedural rights are protected, and the proposed procedures set forth by the Receiver simply set out a timeline for resolution of the claims within a framework to expedite the determination of the issues. The procedures and methods for discovery and trial are well within the Court to determine. See F. R. Civ. P. 26(a), 26(b), 26(c), 26(d), 26(f), and Local Civil Rule 26-1 incorporating those rules (conference of parties provides opportunity for modification of discovery and other rules and setting of appropriate time frames and limits on

discovery). The objections in this regard raised by Bame and Adli are pure gamesmanship.

III. THE MOTION FOR RECONSIDERATION IS APPROPRIATE

Bame argues that the Receiver cannot seek reconsideration of the Court's ruling because the Receiver previously asserted in oral argument that bankruptcy was not an appropriate alternative to proceeding in the District Court. Bame's argument is again disingenuous. As reflected in the Receiver's Motion for Reconsideration and as Bame must concede, the issue of bankruptcy was not raised in any of the papers and was not placed at issue in the pleadings. At the oral argument on the Receiver's Motion on May 15, 2006, the Court sua sponte raised the question of the appropriate course for the receivership as a whole, including not only whether the bankruptcy court was the appropriate forum for the determination of the enforceability of the notes and deeds of trust but also for the administration and liquidation of the receivership estate assets as a whole. Due process surely requires that the Receiver be entitled to address through this Motion an issue raised orally for the first time by the Court, not encompassed by the pleadings on the prior Motion and not argued or briefed by the Receiver or the other parties. As reflected in the Motion for Reconsideration, clear error and manifest injustice are specific grounds warranting reconsideration of a Court's ruling, both of which the Receiver contends are present in this case.

Further, the Court denied the Receiver's Motion without prejudice. To the extent this Motion is a renewed motion seeking relief previously denied, this Motion fully complies with Local Civil Rule 7-17 as to renewed motions by providing specific detail of the context in which the issue previously arose and the Court's prior ruling on that issue.

IV. THE APPLICATION BY THE IRWIN GROUP FOR MODIFICATION OF THE PRELIMINARY INJUNCTION ORDER IS IMPROPER AND SHOULD BE DENIED

The Irwin Group's papers filed in response to the Receiver's Motion not only oppose the Motion but seek a modification of the Court's preliminary injunction order to provide for defendant Edward Showalter to assign his equity interest in High Park to certain investors who will supposedly act as assignees for the benefit of all creditors in the case. This "Application" is procedurally defective and fraught with legal, ethical and practical problems that make it substantively untenable.

A. The Application Is Procedurally Improper

First, the application to modify the preliminary injunction order requires a motion to be filed and served on appropriate 21 days' notice under Local Civil Rule 7, which would provide the Receiver and other interested parties 10 days to file opposition to the requested relief from the date of service. The application does not merely seek modification of the asset freeze order to allow Showalter to assign his equity interest in High Park; rather, the application in effect seeks an order terminating the receivership, the remedy provided under the securities laws and a long history of reported decisions under the securities laws to redress violations of the Securities Acts and regulations for the benefit of all potential creditors of the violating parties. This relief is clearly not appropriately requested in an opposition to the Receiver's Motion.

B. The Application Is Not Well-Founded Legally and Factually

Moreover, even if the application were considered by the Court on its merits despite its procedural deficiencies, the Irwin Group cites no legal authority whatsoever for the proposals it advances for the seizure of the receivership assets and the exercise of the ownership and control of the receivership entities through a self-appointed Board of Directors whose members have divergent and conflicting interests but who purport to represent "all creditors." A fundamental premise of the

Irwin and Coleman Groups' proposal to take over the company through this Board of Directors is that completing the repairs and development of the properties of the estate can and should be done without any determination being made first as to the validity, extent and priority of the asserted deeds of trust against the property. That the Irwin Group and Coleman Group under their scheme do not intend to have the validity and enforceability of the notes and deeds of trust determined by the Board of Directors has been made abundantly clear in an e-mail circulated by the Irwin Group's counsel, and instead, the Group indicates that it will be up to individual creditors to challenge the claims and liens of the other creditors at their own expense.[4] The result would be potentially over 100 investor creditors challenging the notes and deeds of trust of the senior lienholders or taking their chances that the senior lienholders will not obtain relief from stay and relying on the implausible scenario that the remodeling and development of the properties will produce sufficient proceeds to pay off all investors, no matter what their lien priority may be.

The Irwin and Coleman Groups' proposal is flawed practically and legally. If the Irwin and Coleman Groups' plan were followed, administrative and legal chaos would ensue and in fact the plan only demonstrates why a single neutral fiduciary is essential to chart a course of action that protects all of the creditors. Whether as a federal equity receivership or as a bankruptcy, the case cannot proceed based on the speculation and hope that completion of repairs, remodeling and/or development of the properties over a period of years will ultimately pay all of the creditors in full. There are ongoing administrative, remodeling and development expenses under this scenario which cannot be justified if the properties are now and will remain in the future wildly overencumbered by

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[4] Of course, there is no wonder why the Irwin Group proposes not to have the validity and enforceability of liens challenged in that the Group claims that almost all of its members hold more senior priority deeds of trust that would be satisfied if left in place.

unchallenged deeds of trust. Even by the Coleman Group's optimistic and unsupported claims, completion and development of the properties may only pay 85% of investor liens. But no explanation is offered as to how the proceeds of sale of the properties can be shared on a pro rata basis to pay 85% to all investors, when liens must be paid in accordance with their recorded priority if they remain of record and are deemed valid and enforceable. Further, creditors whose liens of record are in a higher priority position and are not deemed invalid are not likely to wait for this promised future development to pay their claims when they have unchallenged liens of record and eroding equity.

The position by the Irwin and Coleman Group that the notes and deeds of trust will not be challenged as unenforceable until after remodeling and development is performed is also remarkable based on their unfounded assumption that the receivership entity as a debtor-in-possession in bankruptcy will also be able to borrow funds on a "super priority" basis and develop and sell the properties without first determining the nature, extent and priority of the liens encumbering the properties.

This "super priority" borrowing would be obtained "to improve, rehabilitate and develop the properties so they are able to be marketed." The Coleman Group argues, without a shred of factual or evidentiary support or detail, that the implementation of this "super priority" borrowing and improvement plan will result in all of the investors receiving 85% to 100% recovery on their investment claims. Coleman Group Response, p. 3:23. But nothing in any of the papers filed in response to the Receiver's Reconsideration Motion provides any factual or evidentiary support that these investors can provide adequate protection for the interests of the lienholders that would be primed (subordinated) by the "super priority" borrowing, as required under the provisions of § 364(d) of the Bankruptcy Code for such a borrowing to be authorized. The Coleman Group opines that repairing and completing the remodeling of the properties (at a cost of tens of

thousands of dollars and months of time to complete) and development of the Arizona property (at a cost of over $3 million and one to two years to complete) will pay all the investors a much larger percentage of their claims. However, neither the Coleman Group nor the Irwin Group provide any evidence that the liens on the properties, including those held by institutional creditors and by investors, would not be eroded by "super priority" loans and the risk of failure in remodeling and development. No showing is made as to how adequate protection could be provided to these lienholders as required under Bankruptcy Code sections 364 and 361. In short, "super priority" borrowing cannot be effectuated until the Court determines whether the investor liens are valid.

If the Irwin and Coleman Groups proceed in bankruptcy as if all of the liens are valid, then senior secured lienholders such as Bame and Adli will argue for immediate relief from the automatic stay to foreclose on their senior liens based on lack of equity in the property and based on lack of adequate protection because of their eroding liens. See 11 U.S.C. §§ 362(d)(1) and 362(d)(2).

The Irwin Group also suggests that the assignment of Showalter's stock interest would be in the nature of an assignment for the benefit of creditors. However, the assignment of the stock would not comply with the statutory requirements of an assignment for the benefit of creditors under California law which requires that all non-exempt assets of the defendant be transferred as part of the assignment and that the assignment be for the benefit of all of the defendant's creditors, not just a select group such as the investor creditors. See Cal. Code of Civ. Pro. § 493.010.

The Irwin Group seems to propose that the stock in High Park be assigned to the small group of seven investors to act as "representatives" of the creditors of the estate. The Receiver estimates there are 121 total investors as well as a number of institutional lienholder creditors, employee creditors, the IRS and others with claims against the receivership entities. The Irwin Group seeks to appoint a

selected group of investors to purportedly represent and act on behalf of the "creditors" without regard to what other investors claim are the distinct rights and interests of each investor creditor (see Bame Opposition, pp. 8:27–9:2), much less the clearly divergent and potentially conflicting interests of the other creditor constituencies with claims against the receivership entities. The selection and representation proposed by the Irwin Group is inconsistent with the provisions of the Bankruptcy Code governing the selection of committee members and the standards required for committees appointed in bankruptcy under Chapter 11. See 11 U.S.C. § 1102.

V. CONCLUSION

Based upon the foregoing, the Receiver respectfully requests that the Court grant relief as sought in the Motion for Reconsideration.

Dated: June 12, 2006

McKenna Long & Aldridge LLP
Gary Owen Caris
Lesley Anne Hawes

By: _____
Gary Owen Caris
Attorneys for Permanent Receiver,
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PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the aforesaid county, State of California; I am over the age of 18 years and not a party to the within action; my business address is **444 South Flower Street, Los Angeles, California 90071**.

On June 12, 2006, I served the **RECEIVER'S CONSOLIDATED REPLY TO OPPOSITIONS AND RESPONSE TO MOTION FOR RECONSIDERATION OF RULING ON MOTION BY RECEIVER FOR INSTRUCTIONS AND ORDERS INVALIDATING PURPORTED NOTES AND LIENS SECURING NOTES OF INVESTORS AS SECURED DEBTS AND FOR OTHER RELIEF** on the interested parties in this action by placing the **true copy**/original thereof, enclosed in a sealed envelope, postage prepaid, addressed as follows:

SEE ATTACHED MAILING LIST.

I am readily familiar with the business practice of my place of employment in respect to the collection and processing of correspondence, pleadings and notices for mailing with United States Postal Service.

The foregoing sealed envelope was placed for collection and mailing this date consistent with the ordinary business practice of my place of employment, so that it will be picked up this date with postage thereon fully prepaid at Los Angeles, California, in the ordinary course of such business.

☐ **(STATE)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

☒ **(FEDERAL)** I declare under penalty of perjury that the foregoing is true and correct, and that I am employed at the office of a member of the bar of this Court at whose direction the service was made.

Executed on June 12, 2006 at Los Angeles, California.

Pamela A Coates

Signature

Pamela A. Coates

Print Name

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