

1 DAVID R. ZARO (BAR NO. 124334)
 TED FATES (BAR NO. 227809)
 2 KIM A. BUI (BAR NO. 274113)
 ALLEN MATKINS LECK GAMBLE
 3 MALLORY & NATSIS LLP
 515 South Figueroa Street, Ninth Floor
 4 Los Angeles, California 90071-3309
 Phone: (213) 622-5555
 5 Fax: (213) 620-8816
 E-Mail: dzaro@allenmatkins.com
 6 tfates@allenmatkins.com
 kbui@allenmatkins.com

7 Attorneys for Receiver
 8 Thomas A. Seaman

9
 10 **UNITED STATES DISTRICT COURT**
 11 **NORTHERN DISTRICT OF CALIFORNIA**

12 SECURITIES AND EXCHANGE
 13 COMMISSION,

14 Plaintiff,

15 vs.

16 SMALL BUSINESS CAPITAL CORP.;
 17 MARK FEATHERS; INVESTORS PRIME
 FUND, LLC; and SBC PORTFOLIO
 FUND, LLC,

18 Defendants.
 19

Case No. CV12-03237

**RECEIVER'S RESPONSE TO
 DEFENDANT MARK FEATHERS'
 MOTION TO DISMISS RECEIVER**

Date: February 22, 2013
 Time: 9:00 a.m.
 Ctrm: 4 - 5th Floor
 Judge: Hon. Edward J. Davila

1 Thomas A. Seaman ("Receiver"), the Court-appointed permanent receiver for Small
2 Business Capital Corp. ("SB Capital"), Investors Prime Fund, LLC ("IPF"), SBC Portfolio
3 Fund, LLC ("SPF") and their subsidiaries and affiliates (collectively, the "Receivership Entities")
4 hereby responds to Defendant Mark Feathers' Motion to Dismiss Receiver.

5 As of the date of this filing, Mr. Feather has filed eight separate motions. As best he can,
6 the Receiver also responds to arguments directed at the receivership in Mr. Feathers' other pending
7 motions.

8 I. INTRODUCTION

9 At the outset of the case, the Court found that the Securities and Exchange Commission
10 ("Commission") made a *prima facie* showing that Mr. Feathers and the Receivership Entities
11 violated federal securities laws. On that basis, the Court appointed the Receiver. Mr. Feathers
12 then consented to entry of a Preliminary Injunction Order, making the Receiver's appointment
13 permanent. Thus far, the Receiver has provided three detailed reports to the Court. As discussed
14 in those reports, the Receiver has reduced operating expenses of the companies, is servicing the
15 loan portfolios, and has evaluated and addressed defaults and other issues with borrowers. As a
16 result, the Receiver has increased the monthly profits and cash balances of the companies. The
17 Court recently approved the Receiver's Third Interim Report and ordered that the receivership
18 continue pursuant to the Preliminary Injunction Order. Docket No. 99.

19 The Receiver has also made significant progress in his forensic accounting of the
20 companies' pre-receivership financial activity. The Receiver expects to have a report on his
21 forensic accounting ready when his next interim report is due (January 15, 2013).

22 In his motions, Mr. Feathers makes numerous false statements and baseless accusations
23 against the Receiver. These statements and accusations are addressed below. The Receiver
24 submits that the Motion to Dismiss Receiver presents no basis to terminate the receivership. As
25 the Receiver has explained in his reports, it is in the best interests of the Receivership Entities and
26 their investors for the receivership to continue. Accordingly, the Receiver recommends that the
27 Motion to Dismiss Receiver be denied.
28

II. RECEIVER NEUTRALITY

1
2 Mr. Feathers accuses the Receiver of being an agent of the Commission and contends that
3 five of the six cases listed on the Receiver's website were initiated by the Commission.

4 Mr. Feathers is wrong on both counts. The Receiver is an agent of the Court, not any party to the
5 case, and acts pursuant the Court's orders and the authority granted to him in those orders. The
6 Receiver is neutral and impartial and has no stake in the outcome of the litigation.

7 With regard to cases listed on the Receiver's website, www.thomasseaman.com, the
8 website lists a total of 76 cases, of all different kinds, only five of which were initiated by the
9 Commission (see links on the website under the heading "Cases"). Mr. Feathers confuses the
10 complete listing of cases on the Receiver's website with the short list of "Other Websites" for
11 matters the Receiver is handling. Five of the six "Other Websites" are for cases initiated by the
12 Commission. This is because regulatory receivership matters, *i.e.*, those initiated by governmental
13 agencies, often require a separate website where investors can obtain information about the case.
14 In this case, for example, the Receiver established the website www.sbcapitalreceiver.com, which
15 is updated regularly and used to provide information to investors. The websites helps reduce time
16 spent by the Receiver and his staff responding to investor inquiries, and therefore helps minimize
17 administrative expenses. Other types of receiverships generally do not require separate websites.

18 Mr. Feathers' contention that the Receiver is dependent on or beholden to the Commission
19 has no merit. The Receiver is an agent of the Court and has properly carried out his duties
20 pursuant to the Court's orders.

III. MANAGEMENT OF THE RECEIVERSHIP ENTITIES

21
22 Mr. Feathers makes several accusations regarding the Receiver's management of the
23 Receivership Entities. First, Mr. Feathers contends that the United States Small Business
24 Administration ("SBA") has "rebuffed" the Receiver's efforts to complete certain loan transactions
25 because the Receiver is not running the Receivership Entities the way Mr. Feathers was. This is
26 false.

27 When the Receiver was appointed, three loans totaling approximately \$10 million were
28 scheduled to close almost immediately. The Receiver promptly raised this issue with the Court.

1 The Court held three telephonic hearings at which the Receiver and his counsel, counsel for the
2 Commission, counsel for the SBA, and Mr. Feathers appeared. Ultimately, due to the risk that the
3 SBA would not allow the loans to later be sold via the loan pooling program, the Court accepted
4 the Receiver's recommendation that the loans not be made. This is discussed further in the
5 Receiver's First Status Report, Docket No. 30, pp. 10-11.

6 Later, the Receiver sought to sell two existing SBA 504 loans through the pooling
7 program. The SBA objected due in large part to the serious allegations of fraud against the
8 companies. SBA Opposition to Ex Parte Application, Docket No. 60, p. 2. Contrary to what
9 Mr. Feathers argues, the concerns the SBA expressed about servicing of the loans related to the
10 anticipated length of the receivership, not who or how many people the Receivership Entities have
11 on staff. *Id.* at p. 7 (noting that the loans at issue have 10-year terms and stating that the SBA
12 "will not allow the loans to be sold knowing that the loans will be serviced by a Receiver that is
13 not likely to be in place for the entire term of the loans.") Accordingly, the SBA's decision not to
14 allow the loans to be pooled is the result of factors entirely outside the Receiver's control.¹

15 Mr. Feathers contends that the Receiver should increase profits by making more loans
16 rather than holding cash reserves. However, the goals of the receivership are different than those
17 of the Receivership Entities prior to the Receiver's appointment. The Receiver is charged with
18 marshalling and preserving assets.

19 As discussed above, the Court determined that the Commission made a *prima facie*
20 showing that Mr. Feathers and the Receivership Entities violated federal securities laws. Based on
21 that determination, the Receiver was appointed to preserve and protect the Receivership Entities'
22 assets for the benefit of investors. The Receiver's appointment was made permanent when
23 Mr. Feathers consented to entry of the Preliminary Injunction Order. Rather than continuing to
24 speculate with investor funds, the goal of the receivership is to preserve and protect receivership
25
26

27 _____
28 ¹ Contrary to what Mr. Feathers' suggests in one of his motions (Docket No. 104, p. 5), the SBA
has never questioned the Court's power to appoint a receiver over the Receivership Entities or
the Receiver's authority to service loans made by the Receivership Entities.

1 estate assets, and, once an orderly claims process has been completed, return as much money as
2 possible to investors.

3 For these reasons, the Receivership Entities do not need the same employees they had
4 before. The Receivership Entities are no longer trying to attract investors or processing new
5 investor deposits. Until the Court authorizes distributions from the receivership estate, they are no
6 longer making distributions to investors. The Receivership Entities are also no longer seeking out
7 and evaluating new lending opportunities. The Receiver, his staff, and the employees retained by
8 the Receiver are capable of servicing the existing loans and performing the other functions of the
9 receivership. Most importantly, the Receiver has extensive experience in evaluating businesses
10 and business assets, including lenders and loan portfolios, and maximizing the recovery from such
11 assets.

12 In one of his motions (Docket No. 103), Mr. Feathers argues that the way the former
13 employees were terminated was sudden and devastating to them. The Receiver certainly
14 sympathizes with the former employees. However, receivers must make difficult decisions and
15 often must significantly cut expenses in order to fulfill their duties to preserve and protect
16 receivership assets. This was the situation here. Unfortunately, the majority of the Receivership
17 Entities' former employees were unnecessary to carrying out the present business operations. All
18 former employees were paid through the date of their termination and received paid time off and
19 medical insurance coverage through the end of July 2012. The Receiver is not aware of any
20 amounts owed to former employees.² However, to the extent former employees believe they are
21 owed amounts from the Receivership Entities, they will have the opportunity to present claims.
22 The Receiver intends to seek approval of procedures for the orderly administration of claims in the
23 near future. Once such procedures are approved, a notice will go out to all known investors and
24 creditors, including former employees.

25
26
27
28 ² In light of the serious allegations of fraud against Mr. Feathers, the Court's preliminary finding
that he violated securities laws, and the preliminary injunction entered with his consent, the
Receiver has not paid pre-receivership wages to Mr. Feathers or his wife Natalie Feathers.

1 With regard to the financial performance of the Receivership Entities, prior to the
2 Receiver's appointment, the Receivership Entities' monthly revenue was insufficient to make
3 investor distributions and pay its operating expenses. The total gross interest and servicing
4 income, before any operating expenses, of the performing loans is \$196,500 per month. By
5 comparison, the monthly cash distribution promised to investors is \$301,500. In May 2012, the
6 monthly payroll of the Receivership Entities was \$235,000. Since his appointment, the Receiver
7 has been able to operate the companies at a profit and increase the cash in the receivership estate
8 by \$911,902.34 from the time of his appointment through September 30, 2012. The reduction in
9 payroll and other operating expenses has enabled the receiver to generate operating profits of over
10 \$170,000 per month since his appointment.

11 IV. FORENSIC ACCOUNTING

12 In one of his motions (Docket No. 102), Mr. Feathers requests that the Receiver be ordered
13 to discontinue his forensic accounting work. The forensic accounting is of critical importance in
14 this case. The Receiver has reviewed the Receivership Entities books and records and found them
15 to be incomplete in that the Quickbooks files begin on January 1, 2010, with beginning balances
16 as of that date, and there is no visibility prior to that time. In addition, there are accruals for
17 profits purportedly earned on loans transferred from one Receivership Entity to another at values
18 in excess of the principal balance of the loans. The Receiver has, therefore, begun a cash basis
19 forensic accounting which will determine how much money was raised from investors and how
20 the money was invested or spent. The Receiver has completed an inventory of bank statements for
21 all known bank accounts. Some of these records are missing, and the Receiver has requested,
22 either informally or by subpoena, copies of missing statements, deposits and cancelled checks.

23 In the meantime, the Receiver has developed a Quickbooks model which is essentially a
24 relational database designed to accumulate all cash receipts and disbursements which reconcile to
25 the banking records of the Receivership Entities from January 1, 2007, through the time of the
26 Receiver's appointment. The data is organized into money raising, money lending and
27 intercompany activities and is designed to provide the Receiver, the Court and the parties with the
28 following information:

- 1 • How much money was raised from investors, how much each of them received and
- 2 how much each is owed;
- 3 • Whether the Receivership Entities' lending activities were profitable;
- 4 • The amount of money paid to Mr. Feathers;
- 5 • The identity and location of receivership assets;
- 6 • The identity of potential sources of recovery; and
- 7 • The impact of intercompany asset transfers.

8 V. FOURTH AMENDMENT

9 Mr. Feathers contends that the Receiver has violated his Fourth Amendment rights by
10 refusing to turn over his personal records. As a preliminary matter, the Receiver is an agent of the
11 Court, and therefore, when acting pursuant to Court orders, is entitled to quasi-judicial immunity
12 from claims of constitutional rights violations. *See Mullis v. United States Bankruptcy Court*,
13 828 F.2d 1385, 1390 (9th Cir. 1987); *Bradford Audio Corp. v. Pious*, 392 F.2d 67, 72-73 (2d Cir.
14 1968).

15 Furthermore, the Receiver has never refused to turnover any personal records to
16 Mr. Feathers. Mr. Feathers requested access to the Receivership Entities' former offices in
17 Los Altos to locate personal records. Such access was immediately granted, but Mr. Feathers
18 reported that he was unable to locate the records he wanted. The Receiver's staff was unable to
19 locate them either. Later, after the Los Altos offices were closed and the records were relocated,
20 certain files that appeared to be Mr. Feathers' personal records were located. The Receiver's staff
21 notified Mr. Feathers' immediately and shipped the records to him. The Receiver has no reason to
22 withhold Mr. Feathers' personal records. The short delay in transmitting the records was the result
23 of difficulty in locating them (by the Receiver's staff and Mr. Feathers himself) among the
24 Receivership Entities' numerous boxes of records.

25 VI. FIFTH AMENDMENT

26 Mr. Feathers contends that the Receiver has violated his Fifth Amendment rights, but does
27 not say in what way this occurred. As noted above, the Receiver is immune from such claims. To
28 the extent Mr. Feathers is referring to due process, the Receiver has not deprived Mr. Feathers of

1 anything, has acted pursuant to valid orders of the Court, and has provided Mr. Feathers all notices
2 required by the Federal Rules of Civil Procedure and Local Rules of the Court.

3 **VII. CALIFORNIA BUSINESS AND PROFESSIONS CODE**

4 Mr. Feathers contends that the Receiver has violated the California Business and
5 Professions Code by labeling the link to the website dedicated to this case as "SEC v. Small
6 Business Capital" on his website. To begin with, Mr. Feathers does not identify any specific
7 sections of the Business and Professions Code, so the Receiver is unable to respond to this
8 allegation. Furthermore, Small Business Capital and SB Capital are names frequently used by
9 Mr. Feathers and investors when referring to the Receivership Entities. The receivership includes
10 all subsidiaries and affiliates of Small Business Capital Corp., Investors Prime Fund and
11 SBC Portfolio Fund. Preliminary Injunction Order, Part VII. Small Business Capital, which
12 Mr. Feathers asserts is his sole proprietorship, is very likely an affiliate of Small Business Capital
13 Corp. due to their common ownership, control and identity. Regardless, the Receiver has
14 relabeled the link "SEC v. Small Business Capital Corp." (adding "Corp." to the prior label) on his
15 website, www.thomasseaman.com. The website dedicated to this case,
16 www.sbcapitalreceiver.com, is and has always been entitled "Small Business Capital Corp.
17 Receivership."

18 **VIII. THE BAY ROAD LOAN**

19 Mr. Feathers refers to a construction loan which he identifies as the "Bay Rd. project."
20 The borrower on this loan is 349 First Street, LLC. This is a construction loan that was partially
21 funded at the time the Receiver was appointed. The Receiver has been evaluating the loan, the
22 project, and the extent to which the conditions for making construction disbursements have been
23 satisfied. In that regard, the Receiver has engaged a construction consultant to assist with, among
24 other things, a review of the project, including (i) a review of the current plans and specifications
25 for the project which the borrower has advised have not been finally approved by the City of
26 Menlo Park, (ii) the updated budget received from the borrower, reflecting cost overruns resulting
27 in an overall budget in excess of the loan proceeds available for disbursement, and (iii) verification
28 of the hard and soft construction costs set forth in the updated budget and time to complete

1 construction. The remainder of the loan cannot be funded until the plans have been approved by
2 the city. Once the plans are approved and the profit-sharing agreement is documented and
3 executed (as discussed below), the Receiver will seek authorization from the Court to extend the
4 maturity date and fund the remainder of the loan.

5 Mr. Feathers contends that the Receiver made a "potential oversight" of a profit-sharing
6 agreement with the borrower. The loan file, however, does not contain a profit-sharing agreement.
7 The Receiver discussed this with the borrower who advised that the profit-sharing agreement was
8 never put in writing. The Receiver is now documenting this agreement.

9 IX. THE WHISKEY JUNCTION LOAN

10 Mr. Feathers questions the Receiver's actions with respect to a loan made to Rico Espana
11 secured by property located at 4479 S. Whiskey Slough Road in Holt, California. Mr. Espana
12 borrowed a total of \$1.104 million to purchase and renovate the property, which includes a
13 restaurant/saloon that has been closed for several years. Mr. Espana intended to reopen the
14 restaurant/saloon under the name Whiskey Junction. Mr. Feathers suggests that the Receiver
15 should have continued to fund Mr. Espana's effort to open Whiskey Junction. Mr. Feathers refers
16 to an appraisal from 2007 estimating the property value at \$700,000 and states that there have
17 been improvements to the property in excess of \$300,000.

18 As discussed in the Receiver's reports to the Court, Mr. Espana has no liquor license, no
19 working capital, no ability to service the debt, and wishes to be relieved of his indebtedness to the
20 Receivership Entities. Mr. Espana was apparently a personal friend of Mr. Feathers, having taught
21 karate to Mr. Feathers' children. The Receiver contacted an appraiser and a real estate broker in
22 order to obtain estimates of the property value. The appraiser estimates the value to be \$230,000.
23 The broker estimates the value to be between \$130,000 and \$142,000. Under these circumstances,
24 the Receiver determined that continuing to fund Mr. Espana's efforts to open the restaurant was
25 not a prudent use of receivership estate funds.

26 Mr. Espana indicated he would agree to a short sale or a deed in lieu of foreclosure. After
27 consulting with counsel, the Receiver determined that a foreclosure will be more expedient and
28 less expensive, so a Notice of Default has been recorded and served.

