

1 JOHN B. BULGOZDY (Cal. Bar No. 219897)  
2 Email: bulgozdyj@sec.gov  
3 SUSAN F. HANNAN (Cal. Bar No. 97604)  
4 Email: hannans@sec.gov

5 Attorneys for Plaintiff  
6 Securities and Exchange Commission  
7 Michele Wein Layne, Regional Director  
8 John W. Berry, Regional Trial Counsel  
9 5670 Wilshire Boulevard, 11th Floor  
10 Los Angeles, California 90036  
11 Telephone: (323) 965-3998  
12 Facsimile: (323) 965-3908

13 **UNITED STATES DISTRICT COURT**  
14 **NORTHERN DISTRICT OF CALIFORNIA**  
15 **SAN JOSE DIVISION**

16 SECURITIES AND EXCHANGE  
17 COMMISSION,

18 Plaintiff,

19 vs.

20 SMALL BUSINESS CAPITAL  
21 CORPORATION; MARK FEATHERS;  
22 INVESTORS PRIME FUND, LLC; and SBC  
23 PORTFOLIO FUND, LCC,

24 Defendants.

Case No. 5:12-CV-03237-EJD

**PLAINTIFF SECURITIES AND  
EXCHANGE COMMISSION'S  
OPPOSITION TO DEFENDANT MARK  
FEATHERS' RULE 12(b)(6) MOTION  
TO DISMISS AND REQUEST FOR  
RULE 11 SANCTIONS (Dkt. No. 96)**

Date: February 22, 2013  
Time: 9:00 a.m.  
Place: Courtroom 4

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1 **I. INTRODUCTION**

2 In November 2012, Defendant Mark Feathers filed several motions seeking dismissal of  
3 this action, removal of the court-appointed Receiver and other relief. In this opposition, Plaintiff  
4 Securities and Exchange Commission (the “Commission”) opposes one of these motions –  
5 Feather’s motion to dismiss “the lawsuit for cause, and for plaintiff’s use, and introduction, of  
6 inadmissible evidence,” and “to impose F.R.C.P. Rule 11 sanctions against plaintiff for  
7 employing the use of inadmissible evidence.” Dkt. No. 96 at 1:3, 1:7-8.<sup>1</sup>

8 In his motion, Feathers claims the Commission should not have introduced into evidence  
9 an April 2012 letter that was produced to the Commission by the independent outside auditor for  
10 the mortgage investment funds he managed. The only reason the Commission submitted that  
11 letter to the Court was to refute Feathers’s claim that the attorney for the funds had “signed off”  
12 and approved the offering materials that the Commission alleged were fraudulent. Feathers  
13 made that meritless claim in his request to have his attorney fees be paid from the assets of the  
14 two funds he used to defraud investors.

15 The April 2012 letter at issue was from Dennis Doss of Doss Law, the attorney for the  
16 two funds. However, far from “signing off” on the offering materials, Doss rebuked Feathers for  
17 the fraud that Doss believed Feathers was perpetrating, informed Feathers he would no longer  
18 prepare the fraudulent offering materials, and instructed Feathers to “cease” making misleading  
19 statements to the fund investors.

20 Feathers now contends the letter from Doss is privileged and therefore should never have  
21 been submitted to the Court. That argument has no merit. Any privilege, if one ever existed,  
22 was waived when the letter was given to the funds’ outside auditor and also later produced by the  
23 auditor to the Commission. It was also waived when Feathers put the attorney’s alleged “sign  
24 off” of the fraudulent offering at issue. The letter, therefore, is not privileged, and was submitted  
25 to the Court by the Commission in good faith.

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28 <sup>1</sup> The Commission is filing a separate, omnibus opposition to address Feathers’s other motions  
(Dkt. Nos. 92, 93, 94).

1 Accordingly, the Commission asks that this Court deny, with prejudice and in its entirety,  
2 Feathers's motion to dismiss this action and to impose sanctions (Dkt. No. 96).

3 **II. BACKGROUND**

4 **A. The Defendants' Fraudulent Scheme**

5 This case concerns a \$42 million offering fraud. Defendant Feathers and the firm he  
6 controlled, Small Business Capital Corp. ("SB Capital"), managed two mortgage funds,  
7 Defendants Investors Prime Fund, LLC ("IPF") and SBC Portfolio Fund, LLC ("SPF")  
8 (collectively, the "Funds"). Over the course of several years, and continuing to the day the  
9 Commission commenced this action, SBC and Feathers were unregistered broker-dealers who  
10 ran the Funds as a Ponzi-like scheme, by paying returns to Fund investors that were only  
11 partially funded by the Funds' actual profits. In clear violation of their fiduciary duties, they also  
12 misused Fund assets, created fictitious profits through transactions among the Funds and SBC,  
13 and engaged that were undisclosed and posed serious conflicts of interest. *See* Dkt. No. 7 (Pl.  
14 brief in support of TRO and preliminary injunction) at 3-14 (and evidence cited therein).

15 The Commission filed this action on June 21, 2012. *See* Dkt. No. 1. It sought, and the  
16 Court granted on June 26, a temporary restraining order against all Defendants, an asset freeze,  
17 and the appointment of a temporary receiver. *See* Dkt. No. 5 (*ex parte* application for relief);  
18 Dkt. No. 16 (TRO). Ultimately, the Court concluded that the Commission had submitted  
19 sufficient evidence of the securities fraud violations to establish a *prima facie* case of  
20 securities fraud and a probability of success on the merits, and entered a preliminary injunction  
21 against Defendants and appointed a permanent receiver over the Defendants, both of which  
22 Feathers consented to. *See* Dkt. No. 34 (order) at 1.

23 **B. The Non-Privileged Letter at Issue**

24 On August 3, 2012, counsel for Defendant Feathers submitted a "request for limited use  
25 of his receivership assets to pay for the legal defense in this matter." Dkt. No. 48 (Def. letter-  
26 brief) at 1. The Commission opposed this request because, among other reasons, Feathers did  
27 not have the legal right to use the investors' money to fund his own personal legal defense. *See*  
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1 Dkt. No. 51 (Pl. letter-brief). On September 26, 2012, this Court denied Feather's request, and  
2 instead ordered that \$200,000 be reserved by the Receiver only if Feathers were ultimately  
3 "successful on the final merits of these proceedings." Dkt. No. 70 at 12. Within a month of that  
4 ruling, Feather's counsel requested to withdraw as his counsel, and this Court granted that  
5 request on November 6, 2012. *See* Dkt. No. 87 (motion to withdraw as counsel), No. 98 (order).

6 In connection with its letter-brief opposing Feather's request for attorney fees, the  
7 Commission submitted a two-page letter to Feathers from the Defendants' prior transaction  
8 counsel, Dennis Doss of Doss Law, dated April 24, 2012. *See* Dkt. No. 52 (Bulgozdy Decl.) at  
9 Ex. 2; *see also* Dkt. No. 51 (Pl. letter-brief) at 5 (referring and citing to letter). The Commission  
10 submitted this letter because Feathers had repeatedly claimed in his request for attorney fees that  
11 the Defendants' lawyers and auditors had never found any problems with his fraudulent scheme.  
12 *See* Dkt. No. 48 (Def. letter-brief) at 2, 7-8.

13 Doss's letter, however, squarely refuted such a claim. In that letter, Doss identified not  
14 only material omissions in the Funds' disclosures to their clients, but also appeared to recognize  
15 that Feathers was running a Ponzi scheme, explaining that, because "IPF is not even earning the  
16 7.5% based [*sic*] return being paid to investors," the "investors' capital is being returned to them  
17 without their knowing it" and the Funds were entering into transactions "generating phantom  
18 income to IPF while financially harming [SPF]." Dkt. No. 52 at 1. Doss instructed Feathers "to  
19 cease raising capital" and "cease taking money from IPF that does not comply with the offering  
20 documents." *Id.* at 2.

21 Doss also informed Feathers that he would no longer assist the fraudulent scheme by  
22 writing false and misleading offering materials. Doss wrote that he "will not write any offering  
23 materials that do not adequately and fully disclose the current financial status of IPF." *Id.*

24 Nowhere in the April 2012 letter does Doss mention or even indirectly refer to any  
25 ongoing or anticipated litigation. The letter only cites the numerous misleading activities of the  
26 Funds and their offering materials, and then instructs Feathers to stop the fraudulent activity.

1 This April 2012 letter was submitted to the Court while Feathers was represented by  
2 litigation counsel in this action. At no point did Feathers's counsel object to its disclosure to the  
3 Court.

4 Feathers, now appearing *pro se*, claims the Commission should never had submitted this  
5 letter to the Court because he contends it is privileged. *See* Dkt. No. 96 (Def. motion) at 1. But  
6 what Feathers fails to tell the Court is that this letter – as Commission explained when it  
7 submitted the letter – was provided to the Commission by IPF's outside auditor, Spiegall  
8 Accountancy Corp., during the Commission's investigation of the Defendants that preceded this  
9 enforcement action. *See* Dkt. No. 52 (Bulgozdy Decl.) ¶ 7. Therefore, as discussed below, given  
10 the content and source of the letter, any privilege was clearly waived.

### 11 **III. ARGUMENT**

12 Feather's request to dismiss this action and impose sanctions because the Commission  
13 submitted the April 2012 letter from Doss Law to the Court should be denied. His entire basis  
14 for this extraordinary relief is his claim that the letter was and continues to be privileged. He is  
15 wrong.

#### 16 **A. The April 2012 Letter Is Not Privileged**

17 As the Ninth Circuit has explained, “[t]he attorney-client privilege is strictly construed.”  
18 *Weil v. Investment/Indicators, Research & Management*, 647 F.2d 18, 24 (9th Cir. 1981).  
19 “Accordingly, it has been widely held that voluntary disclosure of the content of a privileged  
20 attorney communication constitutes waiver of the privilege as to all other such communications  
21 on the same subject.” *Id.* Moreover, it is not the burden of the party contesting the privilege to  
22 show that the privilege never existed or was waived. Rather, the burden of establishing the  
23 privilege and a lack of a waiver rests squarely with the party asserting the privilege. *Id.* at 25;  
24 *see also U.S. v. Chevron Texaco Corp.*, 241 F.Supp.2d 1065, 1069 (N.D. Cal. 2002). Feathers  
25 cannot satisfy this burden for several reasons.

26 First, the April 2012 letter between Doss Law and Feathers was provided, at some point,  
27 to the Funds' outside auditor. It is beyond dispute that the auditor possessed the letter because it  
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1 was the auditor who provided it to the Commission during the Commission’s investigation. *See*  
2 Dkt. No. 52 (Bulgozdy Decl.) ¶ 7. Because, by their very purpose, outside auditors are  
3 independent third parties, a client’s disclosure to its auditor of attorney-client privileged  
4 communications constitutes a waiver of that privilege. *See In re Juniper Networks, Inc.*, 2009  
5 WL 4644534, \*2 (N.D. Cal. Dec. 9, 2009); *see also U.S. v. El Paso Co.*, 682 F.2d 530, 539 (5th  
6 Cir.1982). Therefore, whenever the Doss letter to Feathers was given to IPF’s auditor – and it is  
7 beyond dispute that it was – any privilege that may have existed over the letter was clearly  
8 waived.

9         Nevertheless, Feathers argues that disclosing the letter to the outside auditor did not  
10 waive the “privilege.” Dkt. No. 96 (Def. motion) at 2. In support, Feathers cites *U.S. v. Deloitte*  
11 *LLP*, 610 F.3d 129, 140 (D.C. Cir. 2010). But that case concerns the waiver of the work product  
12 doctrine, not the attorney-client privilege. In *Deloitte*, the government argued that when Dow  
13 Chemical gave its auditor, Deloitte, documents prepared in anticipation of litigation, it had  
14 waived any work product protection of those documents. *See id.* at 139. As that court  
15 recognized, “[w]hile voluntary disclosure waives the attorney-client privilege, it does not  
16 necessarily waive work-product protection.” *Id.*; *see also In re Juniper Networks*, 2009 WL  
17 4644534, at \*2 (recognizing this distinction and distinguishing, on that very issue, *Merrill Lynch*  
18 *& Co., Inc. v. Allegheny Energy, Inc.*, 229 F.R.D. 441, 445 (S.D.N.Y. 2004) (where party  
19 arguing waiver of work product conceded documents at issue were not protected by attorney-  
20 client privilege, court held that, unlike attorney-client privileged materials, information protected  
21 by work product doctrine “is not automatically waived by any disclosure to third persons”).

22         Here, Feathers cannot claim, nor has he even tried to claim, that the April 2012 Doss Law  
23 letter constituted work product. It is Feathers’s burden to establish the work product privilege,  
24 and he has not submitted anything to show that this protection applies. And he could not do so  
25 even if he wanted to. While the letter was sent during the Commission’s investigation, and only  
26 months before this action was filed, the document itself makes clear it has nothing to do with  
27 litigation. Doss makes no mention of the Commission’s investigation (indeed, he was not  
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1 Feathers’s counsel for purposes of that non-public inquiry.) Rather, Doss is merely informing  
 2 Feathers that he believes Feathers was operating a fraudulent scheme and that he, as the Funds’  
 3 lawyer, would no longer participate in the fraud by assisting in the preparation of false offering  
 4 materials. Therefore, there is no work product at issue here, and *Deloitte* does not apply.<sup>2</sup>

5 Second, Feathers cannot now claim that the April 2012 letter from Doss is privileged  
 6 after having put his attorney’s advice squarely at issue in this case. “The privilege which  
 7 protects attorney-client communications may not be used both as a sword and a shield.”  
 8 *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992). Thus, if a party asserts a  
 9 defense based on an attorney’s advice or approval of the party’s conduct, then that is considered  
 10 an implicit waiver of any privilege protecting that advice. *See id.*; *Weil*, 647 F.2d at 24-25; *see*  
 11 *also, e.g., U.S. v. Kerr*, 2012 WL 2919450, at \*1-2 (D. Ariz. July 17, 2012); *Liberty Mut. Ins.*  
 12 *Co. v. California Auto. Assigned Risk Plan*, 2012 WL 892188, at \*3 (N.D. Cal. March 14, 2012).

13 Here, Feathers put his counsel’s views about the offering fraud at issue in his request for  
 14 attorney’s fees (*see* Dkt. No. 48).<sup>3</sup> In his letter-brief supporting that request, his litigation  
 15 counsel argued that the Commission’s allegations lacked merit because, among other reasons,  
 16 “all the offering materials were reviewed by sophisticated outside counsel.” Dkt. No. 48 (Def.  
 17 letter-brief) at 2. In fact, Feathers’s litigation counsel specifically referred to Dennis Doss of  
 18 Doss Law when he argued that Feathers “received numerous sign-offs by legal counsel” and that  
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 21 <sup>2</sup> Feathers also never suggests or argues that the Doss Law letter was given to the auditor to  
 22 assist Doss in representing Feathers. Therefore, the limited *Kovel* doctrine has no application  
 23 here. Under *Kovel*, an attorney-client privileged communication can be provided to a third  
 24 party without waiving that privilege only when the client can show that the attorney disclosed  
 25 that privileged information to the third party to assist the attorney for “the effective  
 26 consultation between the client and the lawyer.” *Chevron Texaco Corp.*, 241 F.Supp.2d at  
 27 1071 (*quoting U.S. v. Kovel*, 296 F.2d 918, 922 (2d Cir. 1961)). Not only does Feathers never  
 28 make such an argument, the very content of the letter suggests that this could not have been the  
 case. Nowhere in the letter does Dennis Doss mention the auditor or suggest that he requires  
 the auditor’s assistance. Rather, Doss is only informing Feathers that Doss believes the  
 offerings are fraudulent and that he will no longer prepare fraudulent offering materials.  
 Moreover, as discussed below, this letter was ultimately given to the Commission, so even if  
*Kovel* did apply that privilege was waived.

<sup>3</sup> After submitting this letter-brief, Feathers asserted reliance on counsel as an affirmative  
 defense in his answer to the Commission’s complaint. *See* Dkt. No. 59 at 12.



1 “attorneys drafted the Funds’ offering circular and operating agreement about which the SEC  
2 complains.” *Id.* at 7 and 7, n.1. But, as the April 2012 Doss Law letter shows, Doss had  
3 concluded that the offerings were fraudulent and refused to prepare the offering materials  
4 anymore. The Commission submitted the letter specifically to counter the meritless claim that  
5 the offerings had been “signed off” by attorneys. *See* Dkt. No. 51 (Pl. letter-brief) at 5 (referring  
6 and citing to letter to counter Feathers’s claims of attorney review and “sign off”). Therefore,  
7 Feathers cannot claim a privilege over this letter now, after having put the views of the Funds’  
8 counsel at issue in this case.

9 Third, even if the disclosure of the letter to the auditor or the assertion of the attorney’s  
10 advice were not waivers, the privilege, if any existed, was clearly waived when the auditor  
11 turned that document over to the Commission. *See Weil*, 647 F.2d at 24. IPF’s auditor provided a  
12 copy of the letter to the Commission during its investigation of Feathers while he was  
13 represented by counsel. That disclosure waived any privileged that could possibly have existed.

14 Accordingly, to the extent there ever was a privilege that protected the April 2012 Doss  
15 Law letter, that privilege has clearly been waived.<sup>4</sup>

16 **B. Even If The Letter Were Somehow Privileged, Dismissal Of This Case Is Not**  
17 **Warranted**

18 Because the April 2012 Doss Law letter is not privileged, the relief Feathers seeks under  
19 Rule 11 is clearly not warranted. *See, e.g., Fidelity Nat. Financial, Inc. v. National Union Fire*  
20 *Ins. Co. of Pittsburgh*, 2012 WL 444399, at \*7 (S.D. Cal. Sept. 25, 2012). But even if the Court  
21 were for some reason to hold that the April 2012 letter is privileged, there is no justification for  
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23 <sup>4</sup> Arguably, no privilege could have ever existed because of the crime-fraud exception.  
24 Communications made in connection with a fraud or crime cannot be shielded by the attorney-  
25 client privileged. *See In re Grand Jury Proceedings*, 87 F.3d 377, 381 (9th Cir. 1996). Here,  
26 not only has the Court concluded that a *prima facie* case of fraud has been established, the  
27 Defendants’ own attorney, in the letter at issue, all but acknowledged his unknowing  
28 involvement in the fraud through his preparation of false offering materials. Having  
discovered the fraud, the attorney correctly instructed his client to “cease” the fraud and  
refused to be a part of it. *See id.* at 381-82 (an attorney does not even need to know about the  
fraud for the exception to apply, and a communication is “in furtherance of” a crime or fraud  
“even if the attorney does nothing after the communication to assist the client’s commission of  
the crime”).



1 the relief Feathers requests. The dismissal of an action is a “severe” sanction that is only  
 2 warranted in “extreme circumstances.” *U.S. ex rel. Wiltec Guam, Inc. v. Kahaluu Construction*  
 3 *Co.*, 857 F.2d 600, 603 (9th Cir. 1998). “[B]efore imposing such a sanction the court must  
 4 specifically find that (1) the conduct to be sanctioned was due to wilfulness, fault, or bad faith;  
 5 and (2) there are no less severe alternatives than outright dismissal.” *General Electric Co. v.*  
 6 *Wilkins*, 2012 WL 5387085, at \*4 (E.D. Cal. Nov. 1, 2012).

7 Here, there can be no finding that the Commission acted in bad faith or with wilfulness or  
 8 fault. “Bad faith ... is a ‘high threshold’” showing to make. *Id.* at \*3 (*quoting Mendez v. County*  
 9 *of San Bernardino*, 540 F.3d 1109, 1132 (9th Cir. 2008)). As discussed above, it was Feathers  
 10 who had argued to the Court that Defendants’ counsel had “signed off” and approved the  
 11 offering materials that the Commission alleges (and has, as the Court held, made a *prima facie*  
 12 showing) were fraudulent. Far from bad faith, the Commission only submitted the April 2012  
 13 Doss Law letter to refute this claim. Therefore, even if the Court were to find that the letter was  
 14 privileged – and it clearly is not – dismissal of this case or any other sanctions are not warranted.

#### 15 **IV. CONCLUSION**

16 Therefore, for the foregoing reasons, the Commission asks that the Court deny Feathers’s  
 17 motion to dismiss and sanctions with prejudice and in its entirety, and to grant any other relief  
 18 that is appropriate.

19 DATED: November 19, 2012

Respectfully submitted,

21 /s/ Susan F. Hannan  
 22 JOHN B. BULGOZDY  
 23 SUSAN F. HANNAN  
 Attorneys for Plaintiff  
 Securities and Exchange Commission

**PROOF OF SERVICE**

I am over the age of 18 years and not a party to this action. My business address is:

U.S. SECURITIES AND EXCHANGE COMMISSION, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036-3648  
Telephone No. (323) 965-3998; Facsimile No. (323) 965-3908.

On November 19, 2012, I caused to be served the document entitled **PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S OPPOSITION TO DEFENDANT MARK FEATHERS' RULE 12(b)(6) MOTION TO DISMISS AND REQUEST FOR RULE 11 SANCTIONS (Dkt. No. 96)** on all the parties to this action addressed as stated on the attached service list:

- OFFICE MAIL:** By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.
- HAND DELIVERY:** I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.
- UNITED PARCEL SERVICE:** By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.
- ELECTRONIC MAIL:** By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.
- E-FILING:** By causing the document to be electronically filed via the Court's CM/ECF system, which effects electronic service on counsel who are registered with the CM/ECF system.
- FAX:** By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: November 19, 2012

/s/ Javier Delgadillo  
Javier Delgadillo

1                    **SEC v. SMALL BUSINESS CAPITAL CORP, et al.**  
2                    **United States District Court – Northern District of California**  
3                    **San Jose Division**  
4                    **Case No. 5:12-CV-03237-EJD**  
5                    **LA-4141**

6                    **SERVICE LIST**

7                    Mark Feathers (*via email and U.S. Mail*)  
8                    Email: *markfeathers@sbcglobal.net*  
9                    1520 Grant Rd.  
10                    Los Altos, CA 94024  
11                    ***Defendant Mark Feathers***

12                    David Zaro, Esq. (*via ECF*)  
13                    Allen Matkins Leck Gamble Mallory & Natsis LLP  
14                    515 S. Figueroa Street, 9th Floor  
15                    Los Angeles, CA 90071  
16                    Email: *dzaro@allenmatkins.com*  
17                    ***Attorney for Receiver Thomas Seaman over Defendants Small***  
18                    ***Business Capital Corp.; Investors Prime Fund, LLC; And SBC***  
19                    ***Portfolio Fund, LCC***