

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

8 **UNITED STATES DISTRICT COURT**
 9 **NORTHERN DISTRICT OF CALIFORNIA**

10 SECURITIES AND EXCHANGE
 11 COMMISSION,

12 Plaintiff,

13 vs.

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

18 Defendants.

Case No. CV12-03237

**RESPONSE TO DECLARATION OF
 NATALIE E. FEATHERS IN OPPOSITION
 TO RECEIVER'S PRELIMINARY
 FORENSIC ACCOUNTING REPORT**

Ctrm: 4 - 5th Floor
 Judge: Hon. Edward J. Davila

1 Thomas A. Seaman ("Receiver") Court-appointed permanent receiver for Small Business
2 Capital Corp. ("SB Capital"), Investors Prime Fund, LLC ("IPF"), SBC Portfolio Fund, LLC
3 ("SPF") and their subsidiaries and affiliates (collectively, the "Receivership Entities"), submits this
4 Response to the Declaration of Natalie E. Feathers in Opposition to the Receiver's Preliminary
5 Forensic Accounting Report. Natalie E. Feathers is Defendant Mark Feathers' wife, a former
6 employee of the Receivership Entities, and an investor in IPF.

7 The Receiver's Preliminary Forensic Accounting Report, Docket No. 168, filed on
8 January 15, 2013 ("PFAR"), outlines the status of the Receiver's forensic accounting work and his
9 preliminary conclusions based thereon. In her declaration, Docket No. 182, filed on January 22,
10 2013, Mrs. Feathers contends the PFAR is "rife with errors." To the contrary, there are no errors
11 in the PFAR that materially affect the Receiver's analysis or preliminary conclusions. With the
12 exception of the one correction noted below, the Receiver affirms the information provided in the
13 PFAR.

14 Setting aside the personal attacks on the Receiver, the Receiver addresses the points raised
15 in Mrs. Feathers Declaration as follows:

16 1. Money Raising Activities. Mrs. Feathers asserts that the amount of principal
17 invested by members is inconsistent with the currently outstanding principal owed to members.
18 By subtracting the amount outstanding from the amount invested, Mrs. Feathers arrives at net
19 returned principal of \$18,167,872. More specifically, she states that she does not understand how
20 the amount outstanding can be greater than the amount invested and concludes that there is an error
21 of approximately \$2.4 million in the net source of funds from money raising activities.

22 The outstanding principal exceeds the amount invested because many investors
23 "reinvested" their interest payments, which makes the amount outstanding to them greater than
24 their original investment. The entire variance Mrs. Feathers cites represents reinvested interest in
25 the amount of \$2.4 million. The subject of reinvested interest is covered in section V.E. of the
26 PFAR, which provides the amount of reinvested interest by Fund. The balance of Mrs. Feathers'
27 criticism of the Receiver's money raising analysis is based on her failure to consider reinvested
28 interest. The Receiver's amount of returned principal of \$20,544,947 is correct.

1 2. Money Lending Activities. Mrs. Feathers incorrectly asserts that the money
 2 lending activities are overstated by \$4,174,987. Her analysis in arriving at this variance is
 3 deficient because it ignores that the Funds directly paid certain lending expenses (in addition to
 4 management fees) in the amount of \$4,441,154. The balance of the variance arises from the
 5 difference between the Receiver's net cash used for lending activities of \$19,971,975 as compared
 6 to \$19,705,807 stated in Mrs. Feathers' declaration, a difference of \$266,167.¹ The direct lending
 7 expenses paid by the funds of \$4,441,154 less the \$266,167 fully explains Mrs. Feathers' variance
 8 (\$4,441,154 - \$266,167 = \$4,174,987).

9 3. Cash Balances. Mrs. Feathers asserts that the cash balance in accounts at the time
 10 of the Receiver's appointment of \$10.2 million is inconsistent with the cash balance of
 11 \$9.7 million used by the Receiver. This section of the PFAR analyzed the Funds' sources and uses
 12 of funds, not those of the parent SB Capital, and therefore the cash balance deliberately did not
 13 include the cash on hand at SB Capital of \$263,575. However, Mrs. Feathers is correct in one
 14 respect – while preparing this response, the Receiver discovered that an incorrect cash balance for
 15 SCMF was used. The correct number is \$244,556, not \$24,556 as stated in the PFAR, which
 16 explains the remaining \$220,000 variance. Therefore, the ending cash is \$9.921 million, not
 17 \$9.701 million. For now this correction reduces the amount transferred to SB Capital from
 18 \$9.849 million to \$9.629 million, a difference of \$220,000 or 2.2%. The Receiver notes that his
 19 report is preliminary and a fully reconciled report is being prepared.

20 4. SB Capital Sources and Uses of Funds. As set forth in the PFAR, the total cash
 21 out, which is assumed to have been paid to SB Capital, is arrived at by deduction. Given that that
 22 primary activities of the Receivership Entities were money raising and money lending, and the
 23 cash balances at the time of the Receiver's appointment are known, the remaining amount is an
 24 unaccounted for use of funds in the amount of at least \$9.629 million. As explained in the PFAR,

25
 26
 27 ¹ The Receiver acknowledges that an incorrect number for money lending activities was used on
 28 page 7, line 2 of the PFAR (\$19,705,807). The correct number for money lending activities is
 stated on page 7, line 9 of the PFAR (\$19,971,975).

1 at this point, the total cash out is indeed a plug figure and will be known with more certainty when
2 the forensic accounting work is completed in accordance with the Court's order.

3 5. Forensic Accounting. In this section of her declaration, Mrs. Feathers purports to
4 show that the \$12 million deficiency as reported by the Receiver does not exist. First, the total
5 assets cited in the Receiver's First Interim Report of \$34.1 million includes the bank stock, the
6 Natoma REO, the SBA license and other assets, as well as the loans, some of which were assigned
7 estimated values less than the amount of the outstanding principal owed either because the
8 borrower was in default or the loans were otherwise impaired. This value provides a metric to
9 compare to the amount outstanding to investors. The Receiver would prefer to be able to value the
10 assets at greater than the \$34.1 million initial estimate. Based on all of the records reviewed to
11 date, however, the Receiver stands by his original assessment.

12 Next, Mrs. Feathers questions the figure of \$36 million taken from the balance sheet
13 prepared by the Receiver for the Fourth Interim Report. \$36 million is the amount of cash and
14 unpaid principal of all loans owing to the Receivership Entities without adjustments for defaulted
15 or otherwise impaired loans. In short, the loan balances were put on the Receiver's account at par
16 value so that the Receiver can properly account for interest and principal payments. Mrs. Feathers
17 uses this higher unadjusted loan value, failing to recognize adjustments for defaulted and non-
18 performing loans. The Receiver believes that these adjustments are necessary to reach a more
19 accurate estimated value of the loans.

20 With respect to Sweet Fingers, although it is an REO property, it is still carried as a loan
21 by IPF (with SB Capital as the borrower). Thus, Mrs. Feathers double counts it in her calculation.
22 Moreover the Receiver's loan balance also includes the Rico Espana/Whiskey Junction loan at
23 \$1.103 million when, in reality, it is worth much less (the loan is in default, the borrower has
24 abandoned the property, and the property has been appraised at \$230,000). To further make the
25 \$12 million deficiency disappear, Mrs. Feathers relies on the Manager's Notes owed by SB Capital
26 totaling \$5.7 million and unearned loan premiums purported have a higher market value than their
27 unpaid principal amount by \$1.5 million. Mrs. Feathers does not explain how the \$1.5 million in
28 unearned loan premiums is calculated, which loans it is derived from, or the purported premium

1 for each loan. However, if the loans are ultimately sold at greater than the principal amount owed
2 on them, the Receiver's accounting will be adjusted to reflected the greater value,

3 Finally, the Receiver is not commingling the funds of the estate as Mrs. Feathers suggests.
4 The \$200,000 reserved for Mr. Feathers' potential legal fees is on deposit in a segregated bank
5 account at Wells Fargo Bank. The balance is \$200,051.11. A copy of the bank statement will be
6 provided to Mr. or Mrs. Feathers on request.

7 The following is a table summarizing the variances that comprise the difference between
8 what Mrs. Feathers claims is the value of the assets and the Receiver's assessment:

Description	\$ millions
Unearned premiums on loan sales.	\$1.500
SBA License – Unknown value but included on the Receiver's First Status Report and Inventory at book value.	\$.750
Bank Stock – Unknown value but included on the Receiver's First Status Report and Inventory at an estimated current market value at the time the report was prepared. It has since lost additional value.	\$.327
Manager's Note	\$5.731
Contingency for Potential Loan Losses which is not included in Mrs. Feathers' analysis.	\$2.989
Mrs. Feathers' declaration double counts Sweet Fingers both as a loan and an REO. The book value of the loan is \$900,000. She also lists it as an REO worth \$450,000 for a total of \$1.35 million. It is currently on the market for \$449,000. After selling and carrying costs, the Receiver expects to net approximately \$380,000, meaning Mrs. Feathers has overvalued this asset by \$970,000 in her calculation.	\$.970
Mrs. Feathers' declaration assumes the value of the Espana loan is \$1.1 million. The property has been appraised for \$230, 000. After selling costs and carrying expenses, the Receiver expects to recover approximately \$150, 000, meaning Mrs. Feathers has overvalued this asset by \$954,000 in her calculation..	\$.954
Total Variance in Asset Values	\$13.221

